UNIVERSITY OF NAIROBI

SCHOOL OF LAW

MASTER OF LAWS, (LL.M) THESIS

# THE IMPLICATIONS OF TERRITORIAL JURISDICTION FOR INTERNATIONAL (INCOME) TAXATION: THE KENYAN CASE STUDY

BY

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G62/82671/2015

THESIS SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF MASTER OF LAWS (LLM) DEGREE OF THE UNIVERSITY OF NAIROBI

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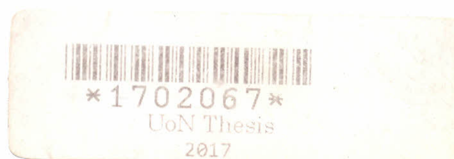
15th December 2017

Word Count: 20, 853 (excluding footnotes and preliminaries)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| **Course Name** | RESEARCH PROJECT, GPR 699 |
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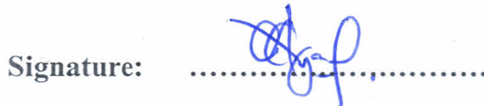
**Signature:** 

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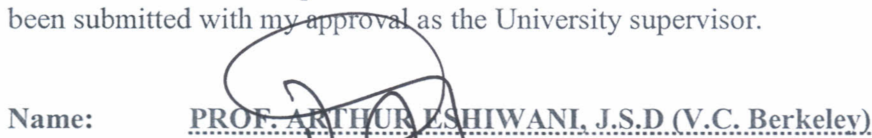

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## DEDICATION

I dedicate this work to my parents, James Kinyua and Margaret Wanjiru. Thank you for the immense support you gave me to undertake this program. If I was the sailor, you were my radars- you steered me forth!

It's a mirage, no, it's a sea

The night is nigh, and winds are cold

No moon on the horizon

It's dangerous, but we must go

It's a trick, no, it's a track

The sailors sleep, and dawn's far ahead

No news up yonder

It's silent, but we must go

It was a sea

There was a track

It was dangerously silent

But we went!

## ACKNOWLEDGMENTS

I am grateful to God, for giving me the wisdom and grace to complete this thesis. The higher the barriers grew, the taller you made me. Thank you LORD!

I also sincerely appreciate the input of my supervisor, Prof. Arthur Eshiwani, "You are a wise old man". God bless you.

I am also grateful to my Thesis panel chaired by Mr. Leonard Aloo, and my reader, Dr. Jackson Bett for their reviews and comments which helped improve the quality of the research.

The support from my parents was immeasurable. May God be gracious to you and add you more years to partake of this well.

My siblings, Njoki and Waweru, don't be afraid to dream and become.

Muriuki Muriungi, you motivated me to keep writing. Thank you.

Ngararu Maina, your insights and comments shaped this thesis from start to end. Thank you.

## Abbreviations of Titles

| | |
|---|---|
| CLCS | Commission on the Limits of the Continental Shelf |
| DTAs | Double Taxation Agreements |
| EAC | East African Community |
| EEZ | Exclusive Economic Zone |
| FDI | Foreign Direct Investment |
| ICJ | International Court of Justice |
| MFN | Most Favoured Nation |
| MOU | Memorandum of Understanding |
| NT | National Treatment |
| OECD | Organisation for Economic Co-operation and Development |
| REI | Regional Economic Integration |
| UN | United Nations |
| UNCLOS | United Nations Convention on the Law of the Sea |
| VCLT | Vienna Convention on the Law of Treaties |

**List of Conventions, Treaties & other International Legal Materials**

1. United Nations Charter, 26 June 1945, San Francisco; UKTS 67 (1946); Cmd. 7015; 1 UNTS.
2. Vienna Convention on the Law of Treaties, 22 May 1969, 1155 UNTS 331; 8 ILM 679 (1969); 63 AJIL 875 (1969).
3. The Montevideo Convention on Rights and Duties of States, 1933 U.ST.S. 881; 165 L.N.T.S. 19; 4 Malloy 4807; 28 A.J.I.L., Supp., 75.
4. The United Nations Convention on the Law of the Sea, 1833 UNTS 3/ [1994] ATS 31/21 ILM 1261 (1982).
5. Charter of the Organisation of African Unity, 25 May 1963, Addis Ababa, 479 UNTS 39; 2 ILM 766.
6. The RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES (1987).
7. Protocol Relating to the Establishment of the Peace and Security Council of the African Union, (adopted 09 July 2002; entered into force 26 December 2003); Reprinted in (2002)10 AYIL 663.
8. The United Nations Model Double Taxation Convention between Developed and Developing Countries (United Nations, New York, 2001), ST/ESA/PADPSER.E.21, www.un.org/esa/ffd/wpcontent/uploads/2014/09/DoubleTaxation.pdf.
9. The United Nations Model Double Taxation Convention between Developed and Developing Countries (United Nations, New York, 2011) www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf.
10. The Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and Capital, 2014 www.oecd.org/ctp/treaties/2014-model-tax-convention-artciles.pdf.
11. East African Community Agreement between The Governments of The Republics Of Kenya, Uganda, Burundi, Rwanda and The United Republic of Tanzania for the Avoidance of Double Taxation and The Prevention of Fiscal Evasion With Respect to Taxes on Income www.EAC%20double%20taxation%20agreement&oq=EAC%20double%20taxation%20agreement

**Table of Cases**

1. *Adams Mfg. Co. v. Storen, 304 U.S. 307, S. Ct. 913;*
2. *Argentina/Chile (Beagle Channel)* (1977) 21 RIAA 53;
3. *Award in the arbitration regarding the delimitation of the maritime boundary between Guyana and Suriname, Award of 17 September 2007, Permanent Court of Arbitration, Volume XXX, 2012, pp.1-144 or Guyana and Suriname, Award of 17.9.2007, 47 ILM 166 (2008);*
4. *Ayrshire Pullman Motor Services v. I.R.C.,* (1920) 14 T.C. 754;
5. *Burkina Faso/Mali* case ICJ Reports, 1986, p. 554; 80 ILR;
6. *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, (1981) ;
7. *Compañia General de Tobacos de Filipinas v Collector of Internal Revenue*, 275 U.S. 87 (1927);
8. *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, (1977);
9. *Cook v Tait (Collector of Inland Revenue),* 265 U.S. 47 (1924) (44 S.Ct. 444, 68 L.Ed. 895);
10. *De Beers Consolidated Mines Limited v Howe (Surveyor of Taxes),* (1906)5 TC 198;
11. *Eritrea v Yemen, Award on Territorial Sovereignty and Scope of the Dispute,* (1998) XXII RIAA 211, (1999) 119 ILR 1, (2001) 40 ILM 900, ICGJ 379 (PCA 1998), 9th October 1998, Permanent Court of Arbitration [PCA];
12. *Eritrea v Yemen (Territorial sovereignty)* (1998) 114 ILR 1;
13. *Eritrea/Ethiopia Claims Commission: Central Front, Ethiopia's claim no. 2, Partial Award of 28.4.2004,* 43 ILM 1275 (2004);
14. *Ethiopia's Damages Claims*, Final Award of 17.8.2009, 49 ILM 177 (2010);
15. *Guyana and Suriname*, Award of 17.9.2007, 47 ILM 166 (2008) (*Guyana/Suriname* Award);
16. *Gwin, White & Prince v Henneford,* 305 U.S. 434, 59 S. Ct. 325;
17. *International Textbook Co. v Pigg,* 217 U.S. 91, 107, 30 S. Ct. 481 (1910);
18. *Jus ad bellum* award of the Eritrea/Ethiopia Claims Commission, Ethiopia's Claims no. 1-8, Partial Award of 19.12.2005, 45 ILM 430 (2006);
19. *Jus ad Bellum, Guidance Regarding Jus ad Bellum Liability*, Decision no. 7 of 27.7.2007, 46 ILM 1121 (2007);
20. *Land and Maritime Boundary between Cameroon and Nigeria (Judgment)*, ICJ Reports, 2002;
21. *Land, Island and Maritime Frontier Dispute (El Salvador/Honduras; Nicaragua Intervening)* case, ICJ Reports, 1992, p.351; 97 ILR;
22. *National Bellas Hess, Inc. v. Department of Revenue,* 386 U.S. 753 (1967);
23. *Nationality Decrees in Tunis and Morocco,* P.C.I.J. Rep., Series C, No.2, pp. 106,108;
24. North Sea Continental Shelf Cases (Federal Republic of Germany/ Denmark and Netherlands) (1969) ICJ Rep 3;
25. *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, (1959);
26. *Opinion No.1 of the Arbitration Commission of the European Conference concerning the case of the former Yugoslavia* 92 ILR;
27. *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992);
28. *Sir George Arnautoglu v Commissioner of Income Tax,* (1967) E.A.L.R. p.312;
29. *Unit Construction Limited v Bullock,* (1960) AC 351;
30. *Vine light Nominees Ltd v the Commissioner of Inland Revenue,* 2012 NZHC p 3306 or 2012 (25) NZTC 20-155.

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# CHAPTER ONE: INTRODUCTION

## 1.1.Introduction

This thesis analyses the implications of territorial jurisdiction for the exercise of the right to tax by sovereign states. It examines the general characteristic of defined territory as one of the tenets of the concept of a state and analyses how disputed boundaries limit the right of a state to exercise fiscal sovereignty over its territory. The thesis focuses on the scope of Kenya's authority to tax income deriving from its territory in light of the existence of three disputes as to its territory, namely, the *boundary of north-east of Kenya* which has been the subject of contention between the Kenya and Somali at the International Court of Justice (ICJ), the *Elemi/Ilemi triangle*, which has been the subject of dispute between Ethiopia and Kenya, and the *Migingo Island* which has been the subject of contention for ownership by both Kenya and Uganda.

Generally, international law is premised upon the idea of a state, which is qualified as such through the use of four-pronged criteria comprising: a defined territory, the existence of a permanent population; presence of a government; and the capacity to enter into relations with other states.[1] However, as will be explained in the ensuing parts of the research, it will be observed that despite the existence of these parameters, the boundaries and territory of a state may not be easily ascertainable. Disputes over the aforementioned boundaries give rise to pertinent questions regarding Kenya's territorial sovereignty and the scope or jurisdiction of her right to tax. It is against this background that this research seeks to examine the implications of territorial jurisdiction on Kenya's right to tax *income* accruing from an economic activities undertaken within her disputed territories.[2]

Taxation by sovereign states is a source of revenue generation. Revenue generation underwrites the fiscal ability of states to discharge their duties and implement their goals. Additionally, revenue production influences the conduct of state-society relations, and shapes the intricate balance between accumulation and redistribution of wealth, a role that accords a state its social-economic character.[3] Taxation as a major source of government revenue enables states to develop socio-economically. Oliver Wendell Holmes Jr., reached a similar conclusion. He

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[1] D.J. Harris, *Cases and Materials on International Law* (7th edn, Thomson Reuters (Legal) Limited, London, 2010), at p.94.

[2] There are different types of taxes in Kenya, namely, PAYE (Pay As You Earn), Corporation Tax, Withholding tax, and Advance tax. See the discussion in <http://www.revenue.go.ke/index.php/domestic-taxes/income-tax/type-of-taxes> (accessed 14 October 2016).

[3] Deborah A. Bräutigam, *Introduction: taxation and state-building in developing countries* (Cambridge University Press, New York, 2008).

observed that "taxes are the price we pay for a civilised society," a phrase derived from his judgment (dissenting) in *Compañia General de Tobacos de Filipinas v Collector of Internal Revenue.*[4] In effect, when a sovereign state is devoid of the power to tax and/or raise revenue, it is undoubtedly limited in its obligations of providing, amongst other things, security, education, and health to its citizens.[5] The three are paramount needs which when effectively delivered, place a state on a global platform in terms of competitiveness, progress, and development.

A state unable to collect much in the form of taxes will also be limited in other secondary objectives, for example, the need to foster economic growth in its territory.[6] The importance of taxes cannot be overemphasised, because they not only help create a state, but also form it.[7] In view of the foregoing, some authors have actually called on states to diversify their sources of revenue generation because small-scale collection of taxes predictably leads to poverty and lack of development.[8]

This thesis seeks to analyse the implications of territorial jurisdiction for international taxation in Kenya. Defined territory is a key tenet of a state, and is critical because it is the basis upon which internationally recognised principles of the United Nations (UN) such as sovereignty[9] and political independence of a state,[10] are asserted. Without territory, an entity cannot be a state,[11] and the principle of sovereignty will not arise.

When territory is determined, a state will exert sovereignty over the area, thus the term territorial sovereignty.[12] Territorial sovereignty imports the idea of independence or autonomy of a state which creates certain rights and duties. It is able to exercise jurisdiction or control over persons or property within its territory, among other rights, and is bound to refrain from interfering with the sovereignty of other states, or in other words, to respect the territorial integrity of other

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[4] *Compañia General de Tobacos de Filipinas v Collector of Internal Revenue*, 275 U.S. 87 (1927).
[5] Ben Sihanya, 'Devolution and education law and policy in Kenya' (Kenya Human Rights Commission (KHRC) workshop on Devolution in Kenya, Palacina Hotel, Nairobi, August 2013). Available at <www.innovativelawyering.com/attachments/article/19/Devolution%20and%20education%20law%20and%20policy%20in%20Kenya%20working%20draft.pdf> (accessed 3 March 2016).
[6] Deborah A. Bräutigam, *supra* note 1 at p.1.
[7] Swedberg, R. (ed*), Joseph A. Schumpeter: The Economics and Sociology of Capitalism.* (Princeton University Press, Princeton, 1991), at p.108.
[8] Ole Therkildsen, 'Understanding Taxation in Poor Africa Countries: A Critical Review of Selected Perspectives, Forum for Development Studies' [2001]28(1) <http%3A%2F%2Fkms2.isn.ethz.ch%2Fserviceengine%2FFiles%2FEINIRAS%2F27820%2Fichaptersection_singledocument%2F16d8603a-b65a-47ee-b445-cc0c64b40a0c%2Fen%2F2001_01_e.pdf> (accessed 3 March 2016).
[9] United Nations Charter, 26 June 1945, San Francisco; UKTS 67 (1946); Cmd. 7015; 1 UNTS, Article 2(1).
[10] Ibid., Article 2(4).
[11] Robert Y. Jennings and Arthur Watts (eds), *Oppenheim's International Law* (9th ed., Oxford University Press, Oxford, 1992).
[12] Malcolm N. Shaw, *International Law* (6th edn, Cambridge University Press, Cambridge, 2008).

states, among other duties. The duty of a state to respect the frontiers of other state which embodies the principle of territorial integrity has been recognised in the UN Charter,[13] a key international legal instrument.

For purposes of international tax law, the duty to respect the territorial integrity of other states connotes the idea that generally, a state cannot tax income deriving or accruing from another state,[14] and neither can it tax persons who are residents or nationals of another sovereign state. Should this happen, a dispute arises within the realm of international taxation between the two states regarding the question of which state has the right to tax the relevant income or person. Disputes concerning territorial jurisdiction of states are of different categories. A dispute may arise pertaining to a claim by one state of ownership of all the territory that makes up another state, or a dispute arising from a claim of ownership of a part of the territory of another state by one or more states. The Republic of Kenya has been a victim of the latter where many of its borders have been the subject of disputes between several states.

The research may not establish the limits of Kenya's borders, but certainly examines the legal issues arising from the uncertainty of its frontiers with regard to national and international taxation.

## 1.2. Statement of the problem

Disputes as to territories limit the power of sovereign states to exercise jurisdiction over their subjects and property. The right of states to tax ensues from the general authority of a state over its political territory, a sacrosanct principle of international tax law.[15] The problem arises when such territory cannot be well defined due to border disputes emanating from unclear delimitation and demarcation of the boundaries of the taxing state. In such a situation, a state may find itself in breach of the duty to refrain from interfering with the territorial integrity of another state. In effect, such interference may compromise with the right of another state to effectively control its territory, specifically with regard to taxation of its nationals.

In view of the foregoing, the problem this research puts forth is that the uncertainty of what constitutes Kenya's territory as a result of the highlighted boundary disputes limits Kenya's fiscal

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[13] United Nations Charter, *supra* note 10, see Article 2(4).
[14] Reuven S. Avi-Yonah et al., *Global Perspectives on Income Taxation Law* (Oxford University Press, New York, 2011), at p.151.
[15] Reuven S. Avi-Yonah, *International Tax as International Law- An Analysis of the International Tax Regime* (Cambridge University Press, New York, 2007) at p.27.

jurisdiction. The uncertainty as to territory limits the power which can be wielded by Kenya in exercise of its sovereign power, particularly with regard to imposition of taxes on the bases of source and residence.[16]

The definition of the terms 'delimitation' and 'demarcation' is important for elaboration of the problem statement. Delimitation is the process of determining the scope of a state's land, maritime zone, continental shelf and/or its exclusive economic zone through the use of geographical parameters of longitude and latitude. The findings are documented in a chart or map, in order to distinguish between the territories of adjacent states.[17] Demarcation is the physical expression of the lines of delimitation by marking out the boundaries expressed in a chart or map with tangible objects or beacons such stones or posts.[18] Both processes help define with clarity the territory of a state and hence establish its jurisdiction to tax income derived from its territory as against other states claiming jurisdiction to tax the persons whose income is the subject of dispute.

### 1.3.Research methodology

This thesis employs the library based method of research. It makes use of both primary (archival) and secondary sources of data. The sources of primary data utilised are international, regional and national legal instruments, resolutions, declarations, judicial decisions and press releases.

Secondary data used includes books, international and regional journals, reports, and other scholarly literature concerning the implications of territorial jurisdiction for international taxation. The materials relied on are sourced from the University of Nairobi library and also online platforms such as google scholar, HeinOnline, Lexis Nexis and JSTOR, among others.

### 1.4.Theoretical framework

The research is based on two theories: the theory of economic efficiency and the benefits (received) theory.

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[16] This problem is also acknowledged in Reuven S.Avi-Yonah, ibid., at p. 27. Reuven, however, opines that this problem is more complex for Multi-National Companies (MNCs) or rather than for individuals.

[17] Anthony Aust, *Handbook of International Law* (Cambridge University Press, Cambridge, 2005), at p.34.

[18] Ibid.

### 1.4.1. The economic efficiency theory

William Barker, a key proponent of the *theory of economic efficiency* asserts that it permits existence of several compatible or harmonious tax options for purposes of ensuring equity among sovereign nations by equitably dividing the tax base internationally.[19] In both instances, the problem of multiple taxation arises often due to a clash of taxing jurisdictions. Boris Bittker, a contemporary proponent of the theory,[20] opined that the theory of economic efficiency, is in international tax law understood to advance the argument that each nation has the right to tax income that is proportionate to the value added by the relevant taxing nation.[21] The concept of proportionality, a cannon of tax law, as expressed by Adam Smith,[22] helps restrict over-taxation. As was explained by Lord Clyde in *Ayrshire Pullman Motor Services v I.R.C.*:

> "No man…is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow -and quite rightly- to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket…[23]

### 1.4.2. Rationale for the theory of economic efficiency

The theory was developed to help solve problems of tax competition among sovereign nations. It was observed that as a result of the benefits of Regional Economic Integration (REI) such as elimination of barriers to trade and increased Foreign Direct Investment (FDI), many nations, developed ones in particular, viewed taxing practices of other nations as unfair because according to them, the latter were taxing income from an economic activity that would otherwise been said to have taken place within the territories of such developed countries.[24] This allegation is in international tax terms known as 'erosion of the tax base' of the country in which the economic activity in question took place.

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[19] William B. Barker, 'Optimal International Taxation and Tax Competition: Overcoming the Contradictions', *supra* note 28, at p. 162.

[20] Boris I. Bittker, 'Equity, Efficiency, and Income Tax Theory: Do Misallocations Drive Out Inequities,' (1979)16(4). *Faculty Scholarship Series,* Paper 2301 <http://digitalcommons.law.yale.edu/fss_papers/2301> (Accessed 29 March 2016), see pp. 735-736.

[21] Ibid., at p. 162.

[22] C.J. Bullock (ed), *Adam Smith,* The Wealth of Nations (P.F. Collier & Son, New York, 2001).

[23] *Ayrshire Pullman Motor Services v. I.R.C.,* (1920) 14 T.C. 754 at p. 763.

[24] Ibid., at p. 165.

### 1.4.3. The benefits (received) theory

The *benefit received theory* provides that a state should levy taxes based on the benefits conferred on individuals. The major proponents of this theory are Reuven S. Avi-Yonah, a contemporary proponent, John Stuart Mill and Adam Smith, dubbed as the classical proponents. The more benefits a person receives from enjoyment of public services from the relevant state, the higher the amount of taxes that should be levied by the taxing authority of such State. This theory underlays the practice of the US to tax its citizens on income obtained from a foreign source despite them not residing in the US during the relevant year of taxation.[25] This reasoning was judicially codified by the US Supreme Court in the case of *Cook v Tait (Collector of Inland Revenue)*[26] that the US reserves the right to tax its citizens on worldwide income no matter where they live (even if they live overseas) on the basis of the benefits they live. This decision has been the subject of academic criticism because it is doubtful how much benefits a non-resident citizen of the US can receive away from the country.[27]

### 1.4.4. Rationale for the benefits received theory

The United Nations Model Double Taxation Convention between Developed and Developing Countries (UN Model Double Taxation Convention)[28] which was developed to guide conclusion of DTAs between developed and developing countries[29] places more emphasis on source jurisdiction.[30] The researcher's view is that the reasoning behind the proposition is that developing countries are well-endowed with natural raw materials such as oil, gas and other minerals[31] which can be easily exploited by developed countries to the disadvantage of developing countries.

The Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and Capital (OECD Model Double Taxation Convention)[32] was developed

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[25] Reuven S. Avi-Yonah, *International Tax as International Law supra* note 14, at p.22.
[26] *Cook v Tait (Collector of Inland Revenue),* 265 U.S. 47 (1924) (44 S.Ct. 444, 68 L.Ed. 895).
[27] Ibid.
[28] United Nations Model Double Taxation Convention between Developed and Developing Countries (United Nations, New York, 2011) <www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf> (Accessed 26 October 2016), 7th introductory paragraph, at p.vii.
[29] Colby Mangels, *'Review of International Commercial Tax by Peter Harris and David Oliver,'* Berkeley J. Int'l Law (2014)(32)2. <http://scholarship.law.berkeley.edu/bjil/vol32/iss2/10> (Accessed 15 March 2016), at p.475.
[30] UN Model Double Taxation Convention (2011), *supra* note 27, 3rd introductory paragraph, at p.vi.
[31] Kenya, Nigeria, South Africa, Democratic Republic of Congo, Libya, among others.
[32] The Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and Capital, The Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and Capital, 2014 <www.oecd.org/ctp/treaties/2014-model-tax-convention-artciles.pdf> (Accessed 26 October 2016).

to guide conclusion of DTAs among developed countries[33] and gives emphasis to residence jurisdiction. The obvious rationale is that developed countries are considered as the ideal place to establish a business or a dwelling, owing to benefits such as security, good infrastructure and related aspects which create a favourable business environment. Income accruing in this case is taxed because the relevant nation seeks to be 'compensated' for availing such benefits to the relevant persons or entities.

Adam Smith alludes to the benefits received theory by discussing the maxims of tax law,[34] among them equality, certainty, convenience, and efficiency.[35] Adam Smith observes that:

> The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state...[36]

It can be deduced from the above excerpt that in return for the benefit of protection offered by a sovereign state through its government, the subjects of such sovereign must be willing to pay tax in order to facilitate the costs incurred from such expenditures.

### 1.4.5. Shortcomings of the benefits received theory

John Stuart Mill and Adam Smith, the classical theorists recognised that the major flaw of this theory was that it is largely impossible to quantify in monetary terms the value of State services enjoyed by tax-payers. To this end, they resigned to the conclusion that taxes are a necessary evil: they are what we pay for a civilised society; and are a sacrifice for the common good.[37]

Further, the beneficiaries of most public services are the poor. This means that they should ideally be taxed more than the economically advantaged tax payers. In Kenya, the absolute application of this theory would greatly compromise on national values and principles espoused in the Constitution such as social justice, equity, equality, non-discrimination, protection of the marginalised and human dignity.[38]

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[33] Colby Mangels, *supra* note 28, at pp.473 & 475.
[34] C.J. Bullock (ed), *Adam Smith,* The Wealth of Nations (P.F. Collier & Son, New York, 2001), at pp. 1433-4.
[35] Ibid., at pp.1433-7.
[36] Ibid., at p.1433-4.
[37] John A. Swain, in his article 'State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective', 45 Wm. & Mary L. Rev. (2003)45, <http://scholarship.law.wm.edu/wmlr/vol45/iss1/5> (Accessed 22 March 2016), see p. 374.
[38] The Constitution of Kenya, (Government Printers, Nairobi, 2010), Article 10(2)(b).

Chapter 12 of the Constitution of Kenya on Public Finance, under which the tax sub-sector falls clearly stipulates that:

> 201 ... (*b*) the public finance system shall promote an equitable society, and in particular-
> (i) the burden of taxation shall be shared fairly;
> (ii) revenue raised nationally shall be shared equitably among national and county governments; and
> (iii) expenditure shall promote the equitable development of the country including by making special provision for marginalised groups and areas;
> (*c*) the burdens and benefits of the use of resources and public borrowing shall be shared equitably between present and future generations...[39]

The question that arises is, therefore, which is the most efficient or appropriate theoretical approach to taxation? The observation is that both theories are mutually reinforcing, and the proponents of the theories work to supplement or supplant the arguments advanced by the different schools.

## 1.5.Literature review

The research area seeks to examine a local problem but the legal issues involved are international in nature. As a result, the literature reviewed is largely international. The literature reviewed is on the following principal aspects of research:

a. Jurisdiction to tax; and
b. Implications of disputed territory for taxation

### 1.5.1. Jurisdiction to tax

Reuven Avi-Yonah in *International Tax as International Law*,[40] recognizes that the right of states to tax is a well-codified principle of international law. He discusses the issue of territorial jurisdiction to tax by acknowledging the international nature of commercial transactions. He observes that there are various principles that guide international tax law. Among the rules he discusses are the single-tax rule, which is described as the rule that income from cross-border transactions should not be taxed more than once.[41] The goal sought to be achieved under this principle is to avoid the problem of double taxation which not only exerts undue economic pressure

[39] Ibid., Article 201(b) & (c).
[40] Reuven S. Avi-Yonah, *International Tax as International Law supra* note 14, at p. 8.
[41] Ibid.

on tax payers, but also because double taxation may operate at unjustifiably high rates and tend to suppress international investment.[42] To determine which State has the right to tax, he explains that the benefits (received) principle helps assign the right to tax to the appropriate State.[43] Per Avi-Yonah, States which practise source jurisdiction to tax should tax active business income, while passive income should be taxed by States which practice residence jurisdiction to tax. If either of these refrain from taxation, under-taxation and/or zero-taxation ensues,[44] a problem that can be cured through the exercise of such power to tax by any other jurisdiction under the premise of either of the two approaches-residence or source. Aptly put, he advises against under-taxation of cross-border income because it is an inefficient incentive to undertake international rather than domestic investment.[45] The converse (over-taxation) also holds true. This results in the problem of tax erosion of the domestic tax base because the local investors run away.[46]

Avi-Yonah quotes T. S. Adams, who he praises as the engineer of the concept of 'foreign tax credit' to justify taxation:

> The state which with a fine regard for the rights of the taxpayer takes pains to relieve double taxation, may fairly take measures to ensure that the person or property pays at least one tax.[47]

This concept was developed to prevent the problem of zero-taxation, which is cautioned against because it also offers an inefficient opportunity to evade taxation by investing in the country that does not tax.

Another rule discussed by Avi-Yonah is the "first bite at the apple rule," which was first embraced by the League of Nations[48] in 1923. This rule has a close nexus with the single-tax rule because both aim at preventing double or multiple taxation, as well as avoiding zero-taxation. Under the "first bite at the apple rule," the source or territorial jurisdiction has the primary right to tax income deriving within it, while the residence or nationality jurisdiction is obliged to refrain

[42] Ibid., at p.10.
[43] Ibid., at p.8.
[44] Ibid.
[45] Ibid., at p.9.
[46] Ibid.
[47] Ibid., at p.10.
[48] The predecessor of the United Nations (UN).

from taxation of such income by granting tax holidays through ways such as credit or exemptions.[49] The same rule applies where the residence or nationality jurisdiction has the right to tax.

The two approaches of jurisdictions to tax are, however, marred by a myriad of interpretation issues. For instance, it is difficult to state with precision the source of income derived from legal services offered by a firm in country A about the merger or acquisition of subsidiary companies X and Y whose parent companies are resident in different countries, say B and C respectively who run business in many other countries globally. It is equally difficult to assign residence (or nationality) to natural or juridical persons because for purposes of taxation, residence is determined in a variety of approaches in different jurisdictions,[50] as has been considered in the ensuing parts of the research.

The major shortcoming is that the discussion is largely tailored to advance the idea that the US approach of residence jurisdiction to tax, that is, taxing persons on their worldwide income is somewhat superior to all other approaches employed by other jurisdictions. This is an erroneous argument because owing to strategic and other differences, developing and developed countries cannot employ similar approaches to tax.

John A. Swain discusses the tests that can be used to determine the right of a State to tax income.[51] These are the economic presence test and the physical presence (of citizens and corporations) test. His article mainly evaluates the approach of various Courts in disputes involving the taxation of multinational companies (MNCs) on the basis of the aforementioned tests. J.A. Swain observes that owing to the increasing mobility of labour, capital, advancement of technology and the rising of innovative taxing techniques, it is not possible to rely principally on the test of physical presence for a State to assert jurisdiction to tax.[52] Asserting jurisdiction to tax on the basis of physical presence is a threat to the tax base of the taxing State and presents inefficient opportunities for tax avoidance.[53] Again, the economic presence test is rejected on account of the argument that sometimes the connection or nexus of the State with the taxpayer

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[49] Reuven S. Avi-Yonah, *International Tax as International Law, supra* note 14, at p.26.
[50] Ibid., at p.24.
[51] John A. Swain, 'State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective', *supra* note 36.
[52] Ibid., at p.312.
[53] Ibid., at p.325.

### 1.4.1. The economic efficiency theory

William Barker, a key proponent of the *theory of economic efficiency* asserts that it permits existence of several compatible or harmonious tax options for purposes of ensuring equity among sovereign nations by equitably dividing the tax base internationally.[19] In both instances, the problem of multiple taxation arises often due to a clash of taxing jurisdictions. Boris Bittker, a contemporary proponent of the theory,[20] opined that the theory of economic efficiency, is in international tax law understood to advance the argument that each nation has the right to tax income that is proportionate to the value added by the relevant taxing nation.[21] The concept of proportionality, a cannon of tax law, as expressed by Adam Smith,[22] helps restrict over-taxation. As was explained by Lord Clyde in *Ayrshire Pullman Motor Services v I.R.C.*:

> "No man…is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow -and quite rightly- to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket…[23]

### 1.4.2. Rationale for the theory of economic efficiency

The theory was developed to help solve problems of tax competition among sovereign nations. It was observed that as a result of the benefits of Regional Economic Integration (REI) such as elimination of barriers to trade and increased Foreign Direct Investment (FDI), many nations, developed ones in particular, viewed taxing practices of other nations as unfair because according to them, the latter were taxing income from an economic activity that would otherwise been said to have taken place within the territories of such developed countries.[24] This allegation is in international tax terms known as 'erosion of the tax base' of the country in which the economic activity in question took place.

[19] William B. Barker, 'Optimal International Taxation and Tax Competition: Overcoming the Contradictions', *supra* note 28, at p. 162.
[20] Boris I. Bittker, 'Equity, Efficiency, and Income Tax Theory: Do Misallocations Drive Out Inequities,' (1979)16(4). *Faculty Scholarship Series,* Paper 2301 <http://digitalcommons.law.yale.edu/fss_papers/2301> (Accessed 29 March 2016), see pp. 735-736.
[21] Ibid., at p. 162.
[22] C.J. Bullock (ed), *Adam Smith,* The Wealth of Nations (P.F. Collier & Son, New York, 2001).
[23] *Ayrshire Pullman Motor Services v. I.R.C.,* (1920) 14 T.C. 754 at p. 763.
[24] Ibid., at p. 165.

#### 1.4.3. The benefits (received) theory

The *benefit received theory* provides that a state should levy taxes based on the benefits conferred on individuals. The major proponents of this theory are Reuven S. Avi-Yonah, a contemporary proponent, John Stuart Mill and Adam Smith, dubbed as the classical proponents. The more benefits a person receives from enjoyment of public services from the relevant state, the higher the amount of taxes that should be levied by the taxing authority of such State. This theory underlays the practice of the US to tax its citizens on income obtained from a foreign source despite them not residing in the US during the relevant year of taxation.[25] This reasoning was judicially codified by the US Supreme Court in the case of *Cook v Tait (Collector of Inland Revenue)*[26] that the US reserves the right to tax its citizens on worldwide income no matter where they live (even if they live overseas) on the basis of the benefits they live. This decision has been the subject of academic criticism because it is doubtful how much benefits a non-resident citizen of the US can receive away from the country.[27]

#### 1.4.4. Rationale for the benefits received theory

The United Nations Model Double Taxation Convention between Developed and Developing Countries (UN Model Double Taxation Convention)[28] which was developed to guide conclusion of DTAs between developed and developing countries[29] places more emphasis on source jurisdiction.[30] The researcher's view is that the reasoning behind the proposition is that developing countries are well-endowed with natural raw materials such as oil, gas and other minerals[31] which can be easily exploited by developed countries to the disadvantage of developing countries.

The Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and Capital (OECD Model Double Taxation Convention)[32] was developed

[25] Reuven S. Avi-Yonah, *International Tax as International Law supra* note 14, at p.22.
[26] *Cook v Tait (Collector of Inland Revenue),* 265 U.S. 47 (1924) (44 S.Ct. 444, 68 L.Ed. 895).
[27] Ibid.
[28] United Nations Model Double Taxation Convention between Developed and Developing Countries (United Nations, New York, 2011) <www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf> (Accessed 26 October 2016), 7th introductory paragraph, at p.vii.
[29] Colby Mangels, *'Review of International Commercial Tax by Peter Harris and David Oliver,'* Berkeley J. Int'l Law (2014)(32)2. <http://scholarship.law.berkeley.edu/bjil/vol32/iss2/10> (Accessed 15 March 2016), at p.475.
[30] UN Model Double Taxation Convention (2011), *supra* note 27, 3rd introductory paragraph, at p.vi.
[31] Kenya, Nigeria, South Africa, Democratic Republic of Congo, Libya, among others.
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[43] Ibid., at p.8.
[44] Ibid.
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The two approaches of jurisdictions to tax are, however, marred by a myriad of interpretation issues. For instance, it is difficult to state with precision the source of income derived from legal services offered by a firm in country A about the merger or acquisition of subsidiary companies X and Y whose parent companies are resident in different countries, say B and C respectively who run business in many other countries globally. It is equally difficult to assign residence (or nationality) to natural or juridical persons because for purposes of taxation, residence is determined in a variety of approaches in different jurisdictions,[50] as has been considered in the ensuing parts of the research.

The major shortcoming is that the discussion is largely tailored to advance the idea that the US approach of residence jurisdiction to tax, that is, taxing persons on their worldwide income is somewhat superior to all other approaches employed by other jurisdictions. This is an erroneous argument because owing to strategic and other differences, developing and developed countries cannot employ similar approaches to tax.

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[50] Ibid., at p.24.
[51] John A. Swain, 'State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective', *supra* note 36.
[52] Ibid., at p.312.
[53] Ibid., at p.325.

may be too geographically remote,[54] especially where the tax payer is not resident within the State alleging jurisdiction to tax. There is no consensus which test is superior to the other.

In both tests, however, Courts must establish if the test applied satisfies or adheres to the basic elements of a good taxation legal and policy framework such as efficiency, fairness, equity, and administrability among others.[55] Further, the test applied must be capable of ascertainment as to which criterion was applied between *due process* and *commerce clause* approaches.[56] The notion of due process is understood in terms of concepts such as 'fair warning" or 'notice', while commerce clause is best explained in terms of the effect 'structures' of state regulation affect the economy of a State'.[57] On this account, it is possible that taxation may be done properly and be aligned to the tenets of due process but yet place undue or unnecessary burden on intra or inter-state commerce.[58] With respect to due process approach, the litigant will challenge the tax imposed on the grounds that nexus to validate the levy was not established,[59] the apportionment was unfair and that there were no benefits received. With regard to commerce clause approach, a litigant will challenge the legality of tax imposed on the grounds that the tax is discriminatory in that it imposes undue burden on commerce.[60] The fact to be proved is whether the tax is discriminatory rather than burdensome because as was held in the case of *Commonwealth Edison Co. v. Montana,*[61] it is not the duty of the Court to assess the economic burden arising out of the liability to tax.[62]

The purpose of applying either approaches is to establish two things: one, nexus of the State with the taxpayer and two, nexus of the State with the income, transaction, property or activity sought to be subjected to taxation. The tax imposed on the basis of the two types of nexus aforesaid is valid under the commerce clause approach if it can be demonstrated that the tax satisfies the four-pronged criteria espoused in the case of *Complete Auto Transit, Inc. v. Brady.*[63] In this case,

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[54] Ibid.
[55] Ibid., at p.327.
[56] Ibid., at p.328.
[57] Ibid., at p.334.
[58] Ibid.
[59] Jerome R. Hellerstein, *State Taxation: Corporate Income and Franchise Taxes* (Vol. 1, Warren, Gorham & Lamont Publishers, New York, 1983), at p.80.
[60] John A. Swain, 'State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective', *supra* note 36 at p.340.
[61] *Commonwealth Edison Co. v. Montana,* 453 U.S. 609, (1981).
[62] The issue of discrimination arises because the commerce clause was intended to protect inter-state commerce in the U.S. from multiple taxation by the various States, or rather protect it from unnecessary tax burdens. A litigant had to prove that the tax imposed on inter-state commerce was more than the tax levied on domestic or local commerce. See *Adams Mfg. Co. v. Storen, 304 U.S. 307, S. Ct. 913* and *Gwin, White & Prince v. Henneford,* 305 U.S. 434, 59 S. Ct. 325.
[63] *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, (1977).

the Court held that a tax is valid if it is: calculated against a taxpayer who has a considerable[64] nexus with the state; apportioned fairly; not discriminatory and; based on the benefits received from the state.[65] Previously, in an earlier case, *Northwestern States Portland Cement Co. v. Minnesota*,[66] the Court was of the view that establishing nexus and apportioning tax fairly were aspects of due process rather than commerce clause approach.[67]

The major shortcoming is that J.A. Swain limits his article to discussing the nexus of a State with the tax payer in light of the four pronged *'Complete Auto'* criteria.[68] He leaves out the discussion on the nexus of a State with the income, transaction, property or activity in question. Additionally some Courts argue that the due process and commerce clause approaches of establishing nexus are complementary while others argue that the two are severable.[69] Despite the lack of consensus, it is generally agreed that with regard to both clauses, it is not mandatory to establish the physical presence of the tax payer,[70] as economic presence also vests in a State the jurisdiction to tax.

Jerome R. Hellerstein in '*State Taxation: Corporate Income and Franchise Taxes,*'[71] discusses the concept of State taxation in light of income accruing from inter-state or foreign commerce.[72] He describes the term 'commerce' as was broadly defined by Chief Justice Marshall (dissenting) in *Gibbons v. Ogden,*[73] as the "...traffic... commercial intercourse between nations, and parts of nations...". The majority restricted the interpretation of the term to mean "traffic...buying and selling...or interchange of commodities".[74] The later (narrow) view is outdated due to trade developments and growth of national economies around the world.[75] The goal of regulation of

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[64] Or substantial nexus.
[65] Ibid., see p.279 of the case.
[66] *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, (1959).
[67] Ibid., see pp. 464-65 of the case.
[68] John A. Swain, *supra* note 36, at p.328. See also footnote 16.
[69] *National Bellas Hess, Inc. v. Department of Revenue,* 386 U.S. 753 (1967). In this case, the Court opined that the due process and commerce clause approaches of assessing the validity of a State's jurisdiction to tax were indistinguishable. In a later case *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992), the Court undertook to severe due process from commerce clause. The question before the Quill Court was whether the State could coerce a company to collect use tax from its clients if the company's relationship with the State (U.S) was limited to only making use of its mail and common carriers. The Court answered in the negative by relying on grounds of commerce clause and the doctrine of *stare decisis* (it applied the decision in the *National Bellas Hess, Inc. v. Department of Revenue,* 386 U.S. 753 (1967) where the question was also answered in the negative but on grounds of both due process and commerce clause).
[70] John A. Swain, *supra* note 36, at p. 330. See also footnote 32.
[71] Jerome R. Hellerstein, *State Taxation: Corporate Income and Franchise Taxes, supra* note 59.
[72] Ibid., at p.83.
[73] *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, (1824).
[74] Ibid.
[75] Ibid., at p.84.

taxation with regard to inter-state commerce was to prohibit multiple taxation of the accruing income.[76] Put differently, taxation had to be regulated in order to protect inter-state commerce from unnecessary tax encumbrances or burdens emanating from multiple taxation.[77] The concept of inter-state commerce is critical for this research because it involves examination of the place in which a commercial activity was undertaken for purposes of assigning jurisdiction to tax. Additionally it is important to understand the concept of commerce clause in order to facilitate the fair apportionment of tax among States when it is ascertained that the relevant income or activity sought to be taxed accrued or was undertaken in more than one State.

Whereas the book is restricted to examining the jurisdiction of the U.S., this research applies the principles and concepts enunciated by Jerome to the territory of Kenya in order to determine when and how jurisdiction to tax income, persons or entities can be said to be extraterritorial. On this account, the research facilitates enquiry as to whether Kenya is guided by due process or commerce clause approaches when assessing for taxation income derived or activity undertaken across its territory.

Peter Harris in *Income Tax in Common Law Jurisdictions: From the Origins to 1820,*[78] generally undertakes to examine the origins, development and purpose of laws regulating income tax in Britain and its former colonies. According to Harris, source and residence principles of taxation are best analysed through the theories of benefits theory and ability to-pay-theory.[79] There is not much substantially discussed on the theories except the observation that theories of taxation are propounded to justify existing tax practices by States, and not to establish the reasons why certain tax practices were originally adopted.[80] He is of the view that the history of a theory usually facilitates better understanding of the developments in a particular society.[81] This fact is undisputable.

He examines further the history of taxation in Britain in three aspects: land; goods and chattels; and wage earners or labourers (aged 15 years or more).[82] With respect to land, tax was levied to

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[76] Ibid., at p.85.
[77] See the case of *International Textbook Co. v Pigg,* 217 U.S. 91, 107, 30 S. Ct. 481 (1910).
[78] Peter Harris, *Income Tax in Common Law Jurisdictions: From the Origins to 1820* (Cambridge University Press, Cambridge, 2006).
[79] Ibid., at p.6.
[80] Ibid., at p.7.
[81] Ibid.
[82] Ibid., at pp.55-57.

owners or users of such land as was situated in England and Wales;[83] owners of goods and chattels were taxed in places where they dwelled, resided or inhabited;[84] labourers were also taxed in terms of the second aspect, that is, where they kept house or resided. The aspect of dwelling is important for this research. It helps determine which individuals are subject to taxation by virtue of keeping house in the Kenyan territory, and aids in revealing the lacuna created by establishing dwelling or place of residence in order to assess the liability of individuals to income tax.

William B. Barker in *Optimal International Taxation and Tax Competition: Overcoming the Contradictions,*[85] makes a theoretical argument for the need to focus on source taxation because it takes into account the goals of economic efficiency and is fair to tax-payers and the governments of capital-exporting nations.[86] Developing countries like Kenya are such examples of capital-exporting nations. William argues that unlike residence jurisdiction to tax, source jurisdiction is a direct way of appropriately ascribing the tax base to the taxing jurisdiction.[87] This is attributed to the fact that source jurisdiction is concerned with the establishing the country in which the income generating or economic activity took place. The country in which the economic activity is undertaken and/or controlled has the authority to tax the income deriving therefrom.[88] Residence jurisdiction is described to be an indirect method of asserting authority to tax. William argues that instead of focusing on the economy activity giving rise to the taxable income, residence jurisdiction shifts attention to the relevant person or entity.[89] The country which establishes a special connection with a person or entity has the requisite authority to tax their income irrespective of where it accrued.[90] This is termed as taxation of worldwide income.

William acknowledges that difficulties may arise in the two approaches so that the same income is taxed more than once.[91] These conflicts are under three dichotomies: source-source

[83] Ibid., at pp.55-56.
[84] Ibid.
[85] William B. Barker, 'Optimal International Taxation and Tax Competition: Overcoming the Contradictions', *supra* note 18.
[86] Ibid., at p.161.
[87] Ibid., at p.181.
[88] Ibid.
[89] Ibid.
[90] Ibid.
[91] This is double taxation. William suggests that triple taxation may also occur.

conflicts;[92] residence-residence conflicts;[93] and source-residence conflicts.[94] This discussion culminates in the conclusion that in the event of disputes on jurisdiction to tax, a country may agree to cede the right to tax through DTAs to pave way for another country to exercise this right. This is said to be the measure resorted to especially in the case of source-source jurisdiction.

Alfred Nizamie,[95] analyses the characteristics of a state's fiscal jurisdiction and how they interact with other national tax jurisdictions. He goes further to explore the confines beyond which States cannot proceed in collection of taxes. He argues that without such restrictions, conflicts between national jurisdictions erupt, and that close international fiscal cooperation is a panacea to such conflicts.[96] Alfred opines that generally, a country's fiscal jurisdiction is limited by the doctrine of sovereignty. He observes that:

> Fiscal jurisdiction is an attribute of statehood and sovereignty. Jurisdiction is based on a state's sovereignty and can be exercised only when a sovereign (i.e. a state) has the sovereign right to realize appropriate competence under international law...fiscal sovereignty... was determined by Swiss Professor of Law Jean-Marc Rivier as: "Le pouvoir d'édicter des norms de droit fiscal et de les appliquer. It means that without sovereignty jurisdiction does not exist. Limits of sovereign power determine limits of jurisdiction.[97]

The above excerpt underpins the principle of substantial and genuine connection which must be established by the country claiming the right to tax under either source or residence jurisdiction. He goes ahead to explain that there are several factors that establish substantial and genuine connection between the object or subject of taxation and the taxing State, among them: domicile or residence, nationality, business or economic presence in a country, location of property or economic activity in a country from which the income accrues.[98] Sometimes these factors may be

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[92] Occurs where two States claim the right to tax by asserting that the income was sourced from their territory.
See Brian J. Arnold & Michael McIntyre, *International Tax Primer* (2nd edn, Kluwer Law International, The Netherlands, 2002), at p.27.

[93] Occurs where two States assign residence to the same person or entity and thus make them liable to tax based on their world-wide income.
See David G. Smith & Ayesha Macpherson, *Hong Kong Taxation: Law and Practice* (Chinese University Press, Hong Kong, 2008), at p.708.

[94] Occurs where one State claims the right to tax on the basis that the income was sourced from its territory, and the other State claims the right to tax on the basis that the subject of taxation is a resident of that State. See Brian J. Arnold & Michael McIntyre, *supra* note 92.

[95] Alfred Nizamiev, *The Main Characteristics of State's Jurisdiction to Tax in International Dimension,'* University of Georgia School of Law LLM Theses and Essays (2003) Paper 36 <http://digitalcommons.law.uga.edu/cgi/viewcontent.cgi?article=1036&context=stu_llm> (Accessed 29 March 2016).

[96] Ibid., at p.1.

[97] Ibid., at p.6.

[98] Ibid., at p.22.

relied on by more than one jurisdiction to assert the right to tax thereby resulting in conflicts on jurisdiction to tax.[99]

Professor David Gliksberg argues that the two models of jurisdiction to tax, personal and territorial jurisdictions, may occasion conflicts as a result of absence of uniformity and congruence in the principles and tests applied in determination of liability to tax among States.[100] These conflicts emerge when either of the two-pronged criteria for establishing tax jurisdiction to tax clash. Prof. David classifies them as conflicts between: personal jurisdictions; territorial jurisdictions; and territorial-personal jurisdictions.[101] Ordinarily, the terms source-source conflicts; residence-residence conflicts; and source-residence conflicts are used more often than the former.

In his book, Prof. David makes the erroneous assumption that the territories of states are ascertained and indisputable and that their boundaries are properly delimited and demarcated. This is actually untrue. It is clearly demonstrated in this thesis that a number of Kenya's boundaries with several contiguous states are contested, and on this account, it is difficult to state with precision how far Kenya can exercise its territorial jurisdiction to tax.

### 1.5.2. Implications of disputed territory for taxation

The first part of the literature review focused on the types and bases of jurisdiction to tax. This part will analyse literature review on the effect of disputed territory in states for national and international taxation.

Malcolm Shaw in *International Law*,[102] observes that there are various kinds of and grounds for disputes as to state territories. A paragraph from the book is quoted as follows:

> Disputes as to territory in international law may be divided into different categories. The contention may be over the status of the country itself, that is, all the territory comprised in a particular state... Or the dispute may refer to a certain area on the borders of two or more states... Similarly, claims to territory may be based on a number of different grounds, ranging from the traditional method of occupation or prescription to the newer concepts such as self-determination, with various political and legal factors, for example, geographical contiguity, historical demands and economic elements...[103]

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[99] Alfred Nizamiev, *supra* note 95, at p.40.
[100] David Gliksberg, *'The Effect of The Statist-Political Approach to International Jurisdiction of The Income Tax Regime - The Israeli Case,'* Mich. J. Int'l L. (1993-1994)15, at p.464. <http://heinonline.org/HOL/Page?handle=hein.journals/mjil15&div=17&g_sent=1&collection=journals> (Accessed 19 October 2016).
[101] Ibid., at p. 464.
[102] Malcolm N. Shaw, *International Law supra* note 10, at pp.491-492.
[103] Ibid, at pp. 491-2.

The omitted discussions from the excerpt make reference to the claims of Morocco against Mauritania and claims of Arab against Israel regarding disputes as to the entire territory of a state on the first part, and claims of Somali against Ethiopia[104] and Kenya[105] with regard to disputes as to areas along the borders of two or more states, on the other part. Whatever the types of and reasons for territorial disputes are, Shaw clearly observes that the need for clear boundaries cannot be overemphasised.[106]

Malcom Shaw discusses some principles developed in order to ensure stability of boundaries of states. The most notable is the colonial principle of *uti possidetis juris* or *uti possidetis* which means that the frontiers that were determined by colonial powers in pre-independence period were inviolable and would form permanent boundaries of the independent African states.[107] Some argue that the principle of *uti possidetis juris* was unable to solve all territorial and frontier disputes especially in Africa,[108] and it greatly stalled development in the continent because of the emergence of secessionist states on account of the right to self-determination.[109] It is argued that Treaties are the only effective means of ensuing boundary lines are respected and not altered at the whim of states.[110]

This research probes the existence of Treaties establishing boundary lines over the disputed territories between Kenya and the relevant adjacent states, and how effective, if any, the Treaties have helped solved such disputes. It is important to emphasise that the government which is certain as to its state's territory is also certain of its sovereignty or rights over all persons and property within such territory, and its duty towards other states.[111] Chapter two discusses in depth the

[104] South-East boundary of Ethiopia with Somali.
[105] North-East boundary of Kenya with Somali.
[106] Malcolm Shaw, *supra* note 10, at p.496.
[107] Ibid., at pp.527-8. See also the Protocol Relating to the Establishment of the Peace and Security Council of the African Union, (adopted 09 July 2002; entered into force 26 December 2003); Reprinted in (2002)10 AYIL 663, Article 4(i) previously contained in Resolution 16 of 1964 (AHG/Res.16 (1)) of the Organisation of African Unity established under the Charter of the Organisation of African Unity, 25 May 1963, Addis Ababa, 479 UNTS 39; 2 ILM 766.
[108] Because of the emergence of the competing right of people to self-determination, see Malcolm Shaw, *supra* note 12, at p.528-9.
[109] Rechner Jonathan D., 'From the OAU to the AU: a normative shift with implications for peacekeeping and conflict management, or just a name change?' Vanderbilt Journal of Transnational Law (2006) <www.thefreelibrary.com> (Accessed 25 October 2016). Some examples include Western Sahara and the recently new born state of South Sudan.
[110] See *Burkina Faso/Mali* case ICJ Reports, 1986, p. 554; 80 ILR, p. 440; *Land, Island and Maritime Frontier Dispute (El Salvador/Honduras; Nicaragua Intervening)* case, ICJ Reports, 1992, p.351; 97 ILR, p.266; *Land and Maritime Boundary between Cameroon and Nigeria (Judgment)*, ICJ Reports, 2002, p.303.
[111] Malcolm N. Shaw, *International Law*, *supra* note 12, at p.490.

disputed territories and frontiers of Kenya, and explains how the issues affect the various bases for jurisdiction to tax.

Milano and Papanicolopulu[112] irrefutably argue that sovereignty enables states to assert jurisdiction over their territories[113] in exclusion of other states.[114] A state acting without the requisite sovereignty or authority on another states territory does so in breach of international law and the latter has the right to seek redress from the former. It is argued that creating certainty as to territorial boundaries of states comprises three things: drawing a boundary or a line of delimitation; demarcation of the boundaries; and actual expression of the lines of delimitation in maps or charts jointly by the states concerned.[115] The United Nations Convention on the Law of the Sea (UNCLOS)[116] has provided an international framework for the delimitation and demarcation of maritime zones for members of the United Nations including Kenya, Somali, Ethiopia, and Uganda. The cited provisions of the UNCLOS provides insight on the international legal framework applied for the resolution of maritime disputes between states.[117]

Milano and Papanicolopulu further contend that determination of boundaries may be done diplomatically or judicially.[118] They discuss the effectiveness of the two approaches by discussing the rules applicable in determination of territorial and maritime boundaries, and finally an appraisal of the two approaches.

The first rule is that states have the right to act upon their territory and to exclude others from doing so.[119] The territorial boundary dispute between Cameroon and Nigeria (refer to *Cameroon and Nigeria (Judgment)*, ICJ Reports, 2002[120] was judicially settled by the International Court of Justice (ICJ). Cameroon claimed that Nigerian troops had illegally occupied its territory (around Bakassi Peninsula and regions around Lake Chad). ICJ ordered the withdrawal of the troops after effecting a line of delimitation. Judicial determination of the boundaries in this case is faulted because it is argued that the Court did not satisfy itself that Nigeria had complied with the order.

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[112] Enrico Milano and Irini Papanicolopulu, *'State Responsibility in Disputed Areas on Land and at Sea,'* ZaöRV (2011)71, <http://www.zaoerv.de/> (Accessed 23 October 2016).
[113] Territory is interpreted in a broad sense to include land, sea and maritime zones such as Exclusive Economic Zones, Continental Shelf, Deep Sea-Bed, High Seas, and also areas within Polar Regions, Airspace, and Outer Space among other possible precincts which may define a territory.
[114] Milano/Papanicolopulu, *supra* note 112, at pp.588-9.
[115] Ibid., at p.589. See also Anthony Aust, *Handbook of International Law, supra* note 16.
[116] The United Nations Convention on the Law of the Sea, 1833 UNTS 3/ [1994] ATS 31/21 ILM 1261 (1982).
[117] The United Nations Convention on the Law of the Sea (UNCLOS), 1833 UNTS 3 [1994] ATS 31/21 ILM 1261. (1982).
[118] Milano and Papanicolopulu, *supra* note 112, at p.589.
[119] Ibid., at pp.592-3.
[120] *Supra*, footnote 111.

It is reported that despite protests by Cameroon, its properties and the environment around the contested territories remained dilapidated and despoiled.

The second rule is that force or threat of force shall not be used in settling territorial disputes.[121] This rule belongs to the category of *jus ad bellum* rules, recognised under United Nations Charter[122] and customary international law.[123] A state cannot use force to protect its territory integrity when it is violated through the forceful occupation of its territory by another sovereign state. This rule was applied in the 2005 *jus ad bellum* award of the Eritrea/Ethiopia Claims Commission,[124] where the Commission rejected Eritrea's claim that its 1998 military action at the Badme town border was justified use of force falling within the exceptions of the UN Charter[125] on the basis that it was applied as an effort to reclaim control over territory which had been forcefully seized by Ethiopia. According to the Commission, self-defence was not a means of repossessing 'lost' territory.[126] Unnecessary use of force wreak havoc and vexes the peace and quiet of nations because border disputes are a frequent occurrence.[127]

The foregoing discussion is important for this thesis because as aforementioned, boundaries between states may be determined diplomatically or judicially.[128] Diplomacy may entails actions such as bilateral or multilateral boundary treaty negotiations, or out-of-court settlement of boundary disputes. Judicial mechanisms involves submission of the boundary disputes to international courts for settlement, and as observed cautioned earlier, international courts may not necessarily ascertain that the decisions rendered are complied with.[129] This thesis therefore, seeks

[121] Milano and Papanicolopulu, *supra* note 112, at p.597.
[122] The United Nations Charter supra note 10, Article 2(4). The rule against use of force is regarded as a norm of a norm of *jus cogens,* or peremptory norms, that is principles against which derogation is not allowed.
[123] *Supra*, footnote 111.
[124] Ethiopia's Claims no. 1-8, Partial Award of 19.12.2005, 45 ILM 430 (2006).
Other decisions on this matter include: a. Eritrea/Ethiopia Claims Commission: *Central Front*, Ethiopia's claim no. 2, Partial Award of 28.4.2004, 43 ILM 1275 (2004); b. *Jus ad Bellum, Guidance Regarding Jus ad Bellum Liability*, Decision no. 7 of 27.7.2007, 46 ILM 1121 (2007); and c. *Ethiopia's Damages Claims*, Final Award of 17.8.2009, 49 ILM 177 (2010).
[125] The UN Charter, *supra* note 7, Article 2(4) and 51. The recognised exceptions to the prohibition against the use of force by states are self-defence and enforcement actions authorised by the United Nations Security Council (SC).
[126] This rule was also applied in the *Guyana and Suriname, Award of 17.9.2007,* 47 ILM 166 (2008) (*Guyana/Suriname* Award). United Nations, *Award in the arbitration regarding the delimitation of the maritime boundary between Guyana and Suriname, Award of 17 September 2007*, Permanent Court of Arbitration, Volume XXX, 2012, pp.1-144.
[127] The third rule falls into the category of *jus in bello* rules, and is the rule that the law of military occupation will apply when occupation in disputed areas arises as a result of an armed conflict. Under this rule, a state that occasions unlawful damage to persons or property within territory of another state is internationally liable to compensate the affected state. See Milano and Papanicolopulu, *supra* note 112, at p.603.
[128] See footnote 152.
[129] This reveals a lacuna in judicial settlement as a method of resolution of international boundary disputes.

to study the existence and effectiveness, of boundary Treaties, if any, between Kenya and the adjacent states with regard to the disputed territories.

## 1.6.Objectives of the research

Owing to the global nature of trade and commerce, States often engage in cross-border and international transactions in order to steer their national economic development. This is made possible because national borders are, aptly put, artificial in nature.[130] This facilitates the mobility of labour and capital from one or more States to [an]other State(s). These transactions are controlled through various ways including taxation which is a means of generating revenue for the capital or labour exporting country. It is also a means through which States curb the import of harmful products or services, among other ends sought to be achieved through taxation.

By examining the territorial limits of Kenya's jurisdiction to tax, this research aims to meet the following objectives:

a. to determine the effect of Kenya's unclear boundaries with Ethiopia, Uganda and Somali along the Elemi triangle, Migingo Island and the north-east Coast respectively on Kenya's jurisdiction to tax;

b. to establish the source of income accruing on economic activities undertaken along the disputed boundaries of Kenya for purposes of imposing tax;

c. to assess the effectiveness of Kenya's legal framework on taxation of cross-border income; and

d. to evaluate the role of DTAs as mechanisms for the diplomatic resolution of conflicts emanating from jurisdiction to tax.

## 1.7.Hypotheses

Among the propositions that this thesis test are whether:

[130] David Gliksberg, supra note 100, at p.460.

a. The unclear delimitation and demarcation of Kenyan boundaries with Ethiopia, Uganda and Somali along the Elemi triangle, Migingo Island and the north-east Coast respectively limit Kenya's territorial jurisdiction to tax;

b. It is difficult to establish the source of income accruing on economic activities undertaken along the disputed boundaries of Kenya for purposes of imposing tax;

c. Kenya's legal framework on taxation of cross-border income is ineffective; and

d. DTAs are effective mechanisms for the diplomatic resolution of conflicts emanating from jurisdiction to tax.

### 1.8.Research questions

One of the ways of establishing and enforcing national boundaries is through treaties or agreements or through the doctrine of *uti possidetis* (inviolability of colonial boundaries). Clear delimitation and demarcation of national boundaries help ascertain the territory of a State and establish its jurisdiction over persons and property found in such territory. Such jurisdiction vests in the relevant authority of such State the jurisdiction or right to tax its people.

On this account, this thesis asks, and attempts to answer the following questions:

a. What are the implications of the unclear delimitation and demarcation of Kenyan boundaries for Kenya's jurisdiction to tax?

b. What is the criteria applied to determine the source of income accruing on economic activities undertaken along the disputed boundaries of Kenya?

c. What is the status of Kenya's legal framework on taxation of cross-border income?

d. How effective are DTAs as mechanisms for the diplomatic resolution of conflicts emanating from jurisdiction to tax?

### 1.9.Chapter breakdown

The topic of research is discussed in three chapters, structured as follows:

Chapter one is the proposal, and is outlined in the following sub-headings: introduction/background, statement of the problem, research methodology, theoretical framework, literature review, research objectives, hypotheses, research questions and the chapter breakdown. Each of these elements lay the basic foundation of the thesis.

Chapter two is the most comprehensive. It forms the body of the thesis, and discusses the issues set forth for research and analysis of the implications of territorial jurisdiction for international taxation in Kenya. It discusses the following: meaning of territorial sovereignty and jurisdiction to tax, the bases of jurisdiction to tax (source and residence principles) and their relevance, and the scope of Kenya's territorial jurisdiction to tax under which the country's legal framework on taxation is discussed. Further, this chapter discusses the case studies giving rise to the issue of disputed frontiers. The case studies to be discussed are: Ilemi Triangle (Kenya-Ethiopia) Boundary; Migingo Island (Kenya –Uganda) Boundary; and North-East (Kenya-Somali) Boundary. These case studies help investigate the implications of unascertained territory for taxation in Kenya.

Finally, Chapter three culminates the research by discussing the conclusion and recommendations. In so doing, the thesis ultimately evaluates the research hypotheses, answers the research questions and also tests whether the research objectives have been fulfilled.

# CHAPTER TWO: IMPLICATIONS OF TERRITORIAL JURISDICTION FOR INCOME TAXATION IN KENYA

## 2.1. Introduction: Meaning of Territorial Sovereignty and Jurisdiction to Tax

Jurisdiction can broadly be defined as the authority of a state to regulate or control the people or property within its territory. It is a critical tenet of sovereignty, which is demonstrated by means of legislative, executive or judicial action.[1] The actions of these arms of a state impact variously upon the lives of its subjects and their property. In exercise of its jurisdiction, a state causes the creation, alteration, and termination of legal relationships, rights and duties within the rubric of international law. The existence of statehood is important because as strict positivists argue, states are the sole subjects of international law.[2] For an entity to be recognised as a state, it must possess the following attributes:[3] permanent population;[4] existence of a definable territory;[5] government presence;[6] and the capacity to enter into relations with other states.[7] Without these characteristics, an entity: may not be recognised as a state;[8] will not acquire territorial sovereignty over persons in that territory;[9] and is denied the right to claim territorial integrity over the areas whose frontiers are contested.[10]

Judicial and arbitral decisions have reinforced the above mentioned qualifications for establishment of a state. For instance, in *Opinion No.1 of the Arbitration Commission of the European Conference concerning the case of the former Yugoslavia*, it was said that a "state is commonly defined as a community which consists of a territory and a population subject to an organised political authority" and further that "such a state is characterised by sovereignty".[11]

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[1] Malcolm N. Shaw, *International Law* (6th edn, Cambridge University Press, Cambridge, 2008), at p.645.
[2] This position is disputable especially because there are certain entities which have international personality and hence are certainly persons of concern in international law. These are international and regional organisations, non-governmental organisations which are sometimes known as not-for profit organisations in some jurisdictions, public and private companies, as well as groups engaging in international crimes such piracy and terrorism.
[3] See the Montevideo Convention on Rights and Duties of States, 1933 U.ST.S. 881; 165 L.N.T.S. 19; 4 Malloy 4807; 28 A.J.I.L., Supp., 75(1934), Article 1.
[4] Ibid., Article 1(a).
[5] Ibid., Article 1(b).
[6] Ibid., Article 1(c).
[7] Ibid., Article 1(d). See also Malcolm Shaw *supra* note 1, at pp. 199 and 494.
[8] Malcolm Shaw *supra* note 1, at p.494.
[9] Ibid., at p.495.
[10] Ibid., at p.522. Territorial integrity is a sacrosanct principle of international law. The United Nations Charter recognises it under Article 2(4) that, "All Members shall refrain in their international relations from the threat or use of force against the territorial integrity or political independence of any state, or in any other manner inconsistent with the Purposes of the United Nations." The United Nations Charter, 26 June 1945, San Francisco; UKTS 67 (1946); Cmd. 7015; 1 UNTS , see Article 2(4) as read with Article 2(7).
[11] Opinion No.1 of the Arbitration Commission of the European Conference concerning the case of the former Yugoslavia 92 ILR, p.168.

To understand what amounts to territorial sovereignty, it is imperative to describe what amounts to territory. Territory with regard to State comprises land, aerospace, territorial waters, seabed, subsoil, and aspects such as islands, rocks and islets,[12] and it also consists of the population within such boundaries. When territory is determined, the State may exercise power or control over such area. The exercise of sovereign control by a State on its territory underpins the concept of territorial sovereignty and has sometimes been regarded as probably the most 'fundamental concept in international law'.[13] Territorial sovereignty accords a state the right to exercise control over its own territory to the exclusion of any other states.[14] It also imposes upon such sovereign the jural opposite obligation to protect the rights of other states.[15]

Territorial was also defined in the case of *National Decrees in Tunis and Morocco* in the following words:

> ...territory is neither an object nor a substance; it is a framework. What sort of framework? The framework within which the public power is exercised... territory as such must not be considered, it must be regarded as the external, ostensible sign of the sphere within which the public power of the state is exercised.[16]

It can be construed from the above extract that territorial begets authority.[17] Such authority includes the jurisdiction or right to tax as established in international law.[18] So important is the right of a state to tax that it has also been described as an incident of its sovereignty.[19] It follows, therefore, that when the limits of a State's territory are unascertained, it becomes difficult to establish source of income deriving from an economic undertaken in such disputed.

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[12] These aspects constitute territory as determined in the case of *Argentina/Chile (Beagle Channel)* (1977) 21 RIAA 53, at p. 189; and *Eritrea v Yemen (Territorial sovereignty)* (1998) 114 ILR 1, at p. 138-139.
[13] Daniel P. O'Connell, *International Law* (2nd edn., Stevens & Sons Ltd, London, 1970).
[14] Malcolm N. Shaw, *supra* note 1, at p.490.
[15] Ibid.
[16] *Nationality Decrees in Tunis and Morocco,* P.C.I.J. Rep., Series C, No.2, pp. 106,108 (As cited in D.J. Harris, *Cases and Materials on International Law* D.J. Harris, *Cases and Materials on International Law* (7th edn, Thomson Reuters (Legal) Limited, London, 2010), p.198).
[17] D.J. Harris, *Cases and Materials on International Law* (7th edn, Thomson Reuters (Legal) Limited, London, 2010),, at pp. 190-191.
[18] Reuven Avi-Yonah, 'International Tax as International Law,' (2004) University of Michigan Law School Law & Economics Working Papers Archive 4/2007 <www.law.umich.edu/centersandprograms/olin/papers.htm> (accessed 15 March 2016).
[19] Joseph H. Beale, 'Jurisdiction to Tax,' (1919)32(6) Harvard Law Review <www.jstor.org/stable/1327994> (accessed 22 March 2016).

## 2.2. Bases of Jurisdiction to Tax: Source and Residence Principles

The Committee of Experts on International Cooperation in Tax Matters observe that jurisdiction to impose income tax is based either on the relationship of the income (tax object) to the taxing state (commonly known as the source or *situs* principle) or on the relationship of the taxpayer (tax subject) to the taxing state (residence principle.[20]

The distinction between the terms 'source' and 'residence' is important in international tax law. Source pertains to the physical presence of the income or the transaction generating the income within the territory of a state.[21] Income may be taxable under the tax laws of a country because of a nexus between that country and the activities that generate the income. In international usage, a jurisdictional claim based on such a nexus is called source or territorial jurisdiction. The nation that has the right to tax is the nation in which such income derives or accrues. For example, a State would invoke the source principle to tax income derived from the extraction of mineral deposits located within its territorial boundaries.[22] It is described to be *'in rem'* jurisdiction, because that right is claimed against other nations.[23] Source taxation is generally justified from the theoretical approach of benefits received which advances the argument that that the State which has contributed to the creation of the economic opportunities that allow the taxpayer to derive income generated within the territorial borders of the State has the requisite authority to tax that income.[24]

The residence principle looks at the nexus between the taxpayer or person and the nation claiming jurisdiction to tax. Because residence considers the relationship of a person to the taxing state, it is also referred to as personal jurisdiction to tax. A person subject to the residence jurisdiction of a country generally is taxable on his worldwide income without reference to the source or place where the income originated. Residence taxation is described to be *'in personam'*, because it examines the relationship of a person to a taxing state.[25] A country which applies the

[20] Committee of Experts on International Cooperation in Tax Matters, *Note on the Revision of the Manual for the Negotiation of Bilateral Tax Treaties*, Seventh session, Geneva, 24-28 October 2011, Item 5 (h) of the provisional agenda, E/C.18/2011/CRP.11, para. 1.1.
[21] William B. Barker, 'An International Tax System for Emerging Economies, Tax Sparing, and Development: It Is All About Source,' U.Pa.J.Int'l L. (2007)29(2), <http://scholarship.law.upenn.edu/jil/vol29/iss2/> (accessed 10 August 2016), at p.352.
[22] Committee of Experts on International Cooperation in Tax Matters, *Note on the Revision of the Manual for the Negotiation of Bilateral Tax Treaties*, *supra* note 20.
[23] William B. Barker, 'Optimal International Taxation and Tax Competition: Overcoming the Contradictions', Nw. J. Int'l L. & Bus (2002)22(2), <http://scholarlycommons.law.northwestern.edu/njilb/vol22/iss2> (accessed 10 August 2016), at p.181.
[24] C.J. Bullock (ed), *Adam Smith, The Wealth of Nations* (P.F. Collier & Son, New York, 2001), at pp. 1433-4.
[25] Ibid.

residence jurisdiction seeks to tax the relevant persons on their world-wide income so long as their residence is established to be of that country. The test of residence or personal jurisdiction differs across nations. Some apply the test of residence while others the test of nationality. Again, what perceptions of what amounts to residence[26] or nationality[27] may differ across various States.

States may adopt either or both source/territorial and residence/personal jurisdiction to guide their tax laws.[28] The choice of which criterion to apply is arguably based on among other factors, the statist conception of the political philosophies of any country or state,[29] equity,[30] economic efficiency,[31] and economic growth.[32] Greater emphasis has been placed on the first factor-the statist-political conception of a country. In other words, it is possible to tell about the principles and attitudes of any State by carefully studying its tax laws.[33] Even with similar perceptions of equity, economic efficiency and economic growth, it is possible for countries to adopt different jurisdictions to tax because of their statist-political conceptions.[34]

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[26] In international tax law, residence is perceived to be synonymous with the term 'domicile', see Robert C. Lawrence III, *International Tax & Estate Planning: A Practical Guide for Multinational Investors* (2nd edn., Practising Law Institute (PLI), New York, 1989), at pp. 8-9. *Black's Law Dictionary* defines domicile as the place which a person is physically present or a place which a person esteems to be his true and fixed abode which he expects to return to although the person lives elsewhere at the time in consideration. The primary types of domiciles are domicile of birth/origin, domicile by operation of law and domicile by choice, the latter inferring there is an element of change of mind. See Bryan A. Garner, *Black's Law Dictionary* (9th ed., St. Paul, Minn. West, 2009), at pp. 586-7. Some scholars argue that although the terms are used interchangeably particularly in tax statutes, the two concepts are different, in that unlike residence, domicile entails an aspect of permanence and one can only have one domicile at a time. Common law jurisdictions use domicile (residence) as the criterion for resolving conflict of laws issues unlike other jurisdictions (e.g. Latin America and European counties which use nationality as the criteria. Other jurisdictions e.g. Switzerland use a hybrid system by applying a mixture of domiciliary and nationality criteria. For a detailed discussion see Robert C. Lawrence III & Elisa Shevlin Rizzo, 'Basic Conflict of Laws,' Available at <http://apps.americanbar.org/abastore/products/books/abstracts/5430661chap1abs.pdf> (Accessed 23 October 2016), at pp.1-6.

[27] Nationality is perceived to be synonymous with the term citizenship, see *Black's Law Dictionary* at p. 1151. A citizen is defined as a "person who, either by birth or naturalization, is a member of a political community, owing allegiance to the community and being entitled to enjoy all its civil rights and protections; a member of the civil state, entitled to all its privileges" see *Black's Law Dictionary* at p.306. It defines national to mean a member of a nation who owes allegiance to a State which in turn protects him (at p. 1149). The RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES (1987) provides for nationality and domicile or residence as some of the bases for asserting jurisdiction to tax people.

[28] David Gliksberg, *'The Effect of The Statist-Political Approach to International Jurisdiction of The Income Tax Regime - The Israeli Case,'* Mich. J. Int'l L. (1993-1994)15, at p.462. <http://heinonline.org/HOL/Page?handle=hein.journals/mjil15&div=17&g_sent=1&collection=journals> (Accessed 19 October 2016).

[29] Ibid., at p.461.

[30] Ibid., at p.460. With regard to equity, the question is whether the regime of tax equitably subjects its national and international taxpayers to tax liability.

[31] Ibid., at p.460. Economic efficiency is two-pronged: national efficiency and universal efficiency. The question sought to be answered is whether the criterion adopted by a State results in the efficient allocation of resources at national or universal levels respectively.

[32] Ibid., at pp.460-471. Governments may also adopt the criterion of taxation which will steer its nation's economic growth. This is based on how fairly and equitably the economic wealth 'pie' is divided in a State.

[33] Ibid., at p.461.

[34] Ibid., at p.472.

Countries which adopt territorial jurisdiction do so on basis of the political justification that national and foreign persons or entities who produce income within the confines of its territory are obliged to share the burden incurred by its government in creating a viable environment[35] for the production of the income.[36] The statist-political approach in this instance is, therefore, that a state has the exclusive right to tax income derived from its territory.[37]

Countries which adopt personal jurisdiction do so on the basis of the political justification that States have the right to tax their residents or nationals because unlike source/territorial jurisdiction, the focus of residence/personal jurisdiction is on the person rather than the territory of the State.[38] In this case, the statist-political conception is that taxpayers belong to a specific state from which they benefit and must on this account contribute to the expenditures incurred by the government of the state in which they are resident or domiciled.[39]

Generally, most countries assess taxes on the basis of the source/territorial principle which establishes the nexus between the state and / or the taxable transaction undertaken in their territory.[40] The rationale is that one, jurisdiction to tax is based on domestic legislative process, which is regarded as an expression of national sovereignty, and two, that there are no restrictions under international law to the legislative jurisdiction to impose and collect taxes.[41]

### 2.3. Relevance of the Bases of Jurisdiction to Tax

In reference to the bases of jurisdiction to tax, two key issues arise: the unlimited jurisdiction with regard to residence, and limited jurisdiction in relation to the source of income.[42] A state has unlimited fiscal jurisdiction over individuals and companies within its territory. Customary international law leaves it to states to determine who their residents or nationals are, including the nature and extent of presence within the territory that is required.[43] However, jurisdiction to tax on the basis of residence or personal jurisdiction is principally relevant with regard to aliens and

[35] A good working environment entails availability of technology, infrastructure, communications, skilled labour, and an efficient legal or enforcement framework.
[36] David Gliksberg, *supra* note 28, at pp.471-472.
[37] Ibid., at p.473.
[38] David Gliksberg, *supra* note 28, at p.473.
[39] Ibid.
[40] UNCTAD, *Taxation*, UNCTAD/ITE/IIT/16 (United Nations, New York and Geneva, 2000), at p.4.
[41] Ibid, at p.7.
[42] Sjoerd Douma, *'The Three Ds of Direct Tax Jurisdiction: Disparity, Discrimination and Double Taxation,'* (European Taxation, 2006), at p. 523.
<http://eclass.uoa.gr/modules/document/file.php> (Accessed 17 October 2016).
[43] Ibid, p. 523.

foreigners.[44] A State has limited jurisdiction in relation to the source of income because it can only invoke the source principle to tax income derived from its territorial boundaries.[45] Whereas most States utilise both source and residence principles it is noteworthy that in view of the aforementioned advantages, all States utilise the source principle.[46]

The import of the foregoing argument is that for a State to make a determination as to source of income or residence of taxpayers, it must be certain about its territorial boundaries. It also means that where there are instances of unascertained or contested areas within other borderland, there is bound to be a challenge on which party, between the neighbouring states, is entitled to collect with respect to both source and residence as bases of jurisdiction to tax.

### 2.4. Establishing the Scope of Kenya's Territorial Jurisdiction to Tax

#### 2.4.1. The Constitution of Kenya 2010

Efficiency in administration and collection of tax requires that jurisdiction to tax be clearly provided for in law in order to regulate the relations between taxpayers and tax authorities as well as to safeguard taxpayers' rights.[47] The Constitution of Kenya 2010 stipulates that only the national government may impose—(*a*) income tax; (*b*) value-added tax; (*c*) customs duties and other duties on import and export goods; and (*d*) excise tax.[48] However, an Act of Parliament may authorise the national government to impose any other tax or duty, except a tax specified in clause (3) (*a*) or (*b*).[49] A county may impose—(*a*) property rates; (*b*) entertainment taxes; and (*c*) any other tax that it is authorised to impose by an Act of Parliament.[50] However, the taxation and other revenue-raising powers of a county are not to be exercised in a way that prejudices national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labour.[51]

[44] Rutsel Silvestre J. Martha, *The Jurisdiction to Tax in International Law* (Kluwer Law and Taxation Publishers, The Netherlands, 1989), at p.48.
[45] Committee of Experts on International Cooperation in Tax Matters, *Note on the Revision of the Manual for the Negotiation of Bilateral Tax Treaties*, *supra* note 20, at para. 5.
[46] Ibid. See also paragraph preceding footnote 45.
[47] Attiya Waris, 'Taxation without Principles: a Historical analysis of the Kenyan Taxation System,' Kenya Law Review (2007)1, at pp. 272-304.
[48] The Constitution of Kenya, (Government Printer, Nairobi, 2010), Article 209(1).
[49] Ibid., Article 209(2).
[50] Ibid., Article 209(3).
[51] Ibid., Article 209(5).

The expression of Kenya's authority to tax in its supreme law helps ensure that the State's power to levy is not exercised in a way that prejudices national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labour,[52] or in a manner that causes taxpayers to suffer unnecessary tax burden.[53] It is, however important to note that the above constitutional provisions contemplate a situation where Kenya's territorial boundaries are clearly defined and ascertainable.

### 2.4.2. The Income Tax Act, Cap 470 Laws of Kenya

The Income Tax Act[54] provides for a *schedular* approach[55] to taxation of income by the Kenya Revenue Authority (KRA), the taxing authority of Kenya. The approach incorporates both source and residence as bases for jurisdiction to tax. Section 3(2), also referred to as the charging section lists the types of sources of incomes that are taxable.[56] A businessman venturing into business in Kenya is assured that income which is not listed under section 3(2) of the Income Tax Act is not liable to taxation. Again with regard to taxation of persons by virtue of their presence in Kenyan territory, the Income Tax Act provides various tests for determining whether an individual or body of persons is "resident" in Kenya. An individual is resident in Kenya for purposes of taxation if he satisfies the tests expressed under section 2 of the Income Tax Act, namely, whether in the specific year of income under consideration: he has a permanent home in Kenya or whether he was present in Kenya for a period or periods amounting in the aggregate to a 183 days or more or present in Kenya in that year of income and in each of the two preceding years of income for an average of 122 days or more in each year of income.[57]

With respect to body of persons, such is considered to be resident in Kenya by employing the various tests regarding the place of incorporation; place of the management and control;[58] and

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[52] Ibid., Article 209(5).
[53] Adam Smith, *supra* note 24, at p.1437.
[54] The Income Tax Act, Cap 470, Laws of Kenya (Government printer, Nairobi, 1974).
[55] The schedular approach to taxation has been characterised as outdated and traditional, see Colby Mangels, 'Review of International Commercial Tax by Peter Harris and David Oliver,' Berkeley J. Int'l Law (2014)(32)2. <http://scholarship.law.berkeley.edu/bjil/vol32/iss2/10> (Accessed 15 March 2016), at pp.473 & 474.
[56] Such include income from sources such as business profits, capital gains, employment income, and entitlements.
[57] The Income Tax Act, *supra* note 54, section 2. See also the case of *Sir George Arnautoglu v Commissioner of Income Tax,* (1967) E.A.L.R. p.312.
[58] Case law on tests for determining residence of judicial persons or corporations: see *De Beers Consolidated Mines Limited v Howe (Surveyor of Taxes),* (1906)5 TC 198- where directors exercise control or the center of management as a test for corporate residence; *Unit Construction Limited v Bullock,* (1960) AC 351- de jure control of subsidiary companies by directors of parent companies as a test for corporate residence; *Vine light Nominees Ltd v the Commissioner of Inland Revenue,* 2012 NZHC p 3306 or 2012 (25) NZTC 20-155- where directors and/or top management resides as a test for corporate residence.

finally, by a statutory declaration.[59] By virtue of some Kenyan territories being disputed, then the issues are not whether the income in question accrued from sources listed under section 3(2) or whether an individual or body of persons is a resident under the tests provided under section 2. The issues are whether the relevant income generated from the disputed territories can be said to have accrued in Kenya on the first part and whether the relevant persons living or established in the disputed territories can be said to Kenyan residents on the other part.

### 2.4.4. The Maritime Zones Act, Cap 371 Laws of Kenya

The Maritime Zones Act[60] was enacted to consolidate the law relating to the territorial waters and the continental shelf of Kenya; to provide for the establishment of the exclusive economic zone of Kenya; to provide for the exploration and exploitation and conservation and management of the resources of the maritime zones; and other connected purposes.[61] Section 4 of the Act describes what constitutes exclusive economic zone. It provides that:

> 4. (1) There shall be an exclusive economic zone of Kenya.
>
> (2) Subject to subsections (3) and (4), the exclusive economic zone shall comprise those areas of the sea, seabed and subsoil that are beyond and adjacent to the territorial waters, having as their limits a line measured seaward from the baselines, low waterlines or low tide elevations described in the First Schedule, every point of which is 200 nautical miles from the point on the baselines, low water marks or low tide elevations.
>
> (3) The southern boundary of the exclusive economic zone with Tanzania shall be on an easterly latitude north of Pemba Island obtained by the northern inter-section of two arcs one from the Kenya lighthouse at Mpunguti Ya Juu Island, and the other from Pemba Island lighthouse at Ras Kigomasha.
>
> (4) The northern boundary of the exclusive economic zone with Somalia shall be delimited by notice in the Gazette by the Minister pursuant to an agreement between Kenya and Somalia on the basis of international law.

Relevant to the activities carried out within the areas described in section 4 above is section 5 of the Maritime Zones Act which provides that Kenya has the right to exercise sovereign control with respect to the exploration, exploitation, conservation and management of natural resources within the Exclusive Economic Zone (EEZ). The exercise of such control does not entail: exploration and exploitation for the generation of wind or hydro energy; preservation of the marine

[59] The Income Tax Act (Kenya), *supra* note 54, section 2.
[60] The Maritime Zones Act Cap 371, Laws of Kenya, (Government printer, Nairobi, 1989).
[61] Ibid., see the preamble.

environment; establishment of non-natural islands and other artificial installations; or conduct of scientific research.[62]

The First Schedule to the Act describes Kenya's territorial waters as follows:

> The area of the territorial waters of the Republic of Kenya extends on the coastline adjacent to the High Seas to a point twelve international nautical miles seawards from the straight baselines, low water lines or low tide elevations, hereinafter described as follows:
>
> **Commencing on the straight line joining Diua Damasciaca Island and Kiungamwina Island at the point at which this line is intersected perpendicularly by the Median straight line drawn from Boundary Pillar 29 (being the terminal pillar of the Kenya-Somalia boundary)...** [Emphasis mine].[63]

Ian Brownlie points out that apart from land permanently above low-water mark, territorial sovereignty may be exercised over various geographical features associated with or analogous to land territory.[64] Furthermore, according to the principle of appurtenance, the territory of a state by definition and legal implication includes a territorial sea and the airspace above land territory and the territorial sea.[65] Indeed, Sir Arnold (now Lord) McNair in the *Fisheries* case stated that: 'International law imposes upon a maritime State certain obligations and confers upon it certain rights arising out of the sovereignty which it exercises over its maritime territory. The possession of this territory is not optional, not dependent upon the will of the State, but compulsory.'[66]

From the above, it therefore follows that, anyone residing within the areas falling with the territorial borders of Kenya would be deemed to be a national or a resident of Kenya, for purposes of tax obligations under the residence principle.[67] Further, any economic activities carried out within such areas would also be liable to taxation by Kenya Revenue Authority (KRA) as the taxing authority of Kenya under the source principle.[68]

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[62] Ibid., section 5.
[63] The Maritime Zones Act, *supra* note 60, First Schedule.
[64] Ian Brownlie, *Principles of Public International Law*, (Oxford University Press, London, 1966), p.109.
[65] Ibid, p. 112.
[66] Ibid, pp. 112-113.
[67] See the Income Tax Act, *supra* note 54, section 2.
[68] Ian Brownlie, *supra* note 64, at p.187.

### 2.4.5. Kenya Citizenship and Immigration Act, No. 12 of 2011

The Kenya Citizenship and Immigration Act,[69] defines "border" to mean the national borders of Kenya and includes the ports of entry, the coastlines and the outer margin of territorial waters.[70] Also noteworthy is the constitutional provision that Kenya consists of the territory and territorial waters comprising Kenya on the effective date, and any additional territory and territorial waters as defined by an Act of Parliament.[71] Different rules apply with regard to determination of various types of State borders in order to establish with certainty what amounts to a State's territory. It had been observed earlier that State territory comprises land, sea and maritime zones such as the Exclusive Economic Zones (EEZ), Continental Shelf, Deep Sea-Bed, High Seas, and also areas within Polar Regions, Airspace, and Outer Space among other possible precincts which may identify a territory. The disputed territories of Kenya concern disputes as to land (Elemi triangle-Kenya, Ethiopia & South Sudan boundary) and maritime territory dispute between (north-east Kenya-Somali boundary) and (Migingo Island- Kenya-Uganda boundary).

The research does not delve into the study of delimitation and demarcation of various types of State frontiers, but is limited to the discussion on the effect of disputed territories on Kenya's jurisdiction to tax.

### 2.5. Disputed Frontiers: Implications of Unascertained Territory for Income Taxation

It has been pointed out that modern boundaries in Eastern Africa evolved from two broad but distinct pre-colonial traditions of territoriality: centralised states typified by the Ethiopian Empire and African kingdoms around the Great Lakes on one hand, and the numerous stateless communities, on the other.[72] For the most part, most of these boundaries were structured along loose and flexible communal lines to accommodate shifts in political identities and allegiances.

Prior to the formal partition by colonial powers in the mid-1800s, none of these territorial practices had attained regional dominance; rather they coexisted uneasily in the context of constant changes in the military and economic fortunes of major players.[73] Thus, in the post-colonial era, the core of the nation-building enterprise entailed the domestication of the borders inherited from

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[69] Kenya Citizenship and Immigration Act, No. 12 of 2011, Laws of Kenya (Government Printer, Nairobi, 2011).
[70] Ibid, section. 2.
[71] Constitution of Kenya 2010, *supra* note 48, Article 5.
[72] Gilbert Khadiagala, 'Boundaries in Eastern Africa', Journal of Eastern African Studies, (2010) (4(2) 266, at p.266.
[73] Ibid.

colonialism. Domestication is the gradual recognition of the outer reaches of the delimited territorial boundaries, a process that is bolstered internally by the invocation of ideologies of nationalism and the creation of novel sources of legitimating political membership.[74]

In regional interstate relationships, the domestication of borders spawned not just wars and violence, but also bilateral and multilateral efforts to contain conflicts over these borders. As a result, the existing boundaries have remained the definitive forms of statehood, the sites of citizenship, and the arenas of development.[75] They were based mainly on the international law principle of *uti possidetis juris.*

Milano and Papanicolopulu[76] have identified two types of maritime disputes. The first type concerns strictly the drawing of the boundary between the maritime zones claimed by the neighbouring States. They observe that while it is true, as the ICJ has maintained, that delimitation "is a process which involves establishing the boundaries of an area already, in principle, appertaining to the coastal State and not the determination *de novo* of such an area" and notwithstanding the elaboration of a body of principles and rules relating to maritime delimitation, mostly through the decisions of international tribunals, there still is a margin of appreciation (for the judge or the parties) as regards the final boundary line, given that "[t]here will rarely, if ever, be a single line that is uniquely equitable". As long as their claims are reasonable, both States parties to a maritime boundary dispute could have a reasonable chance of getting the maritime area they claim, or at least a part of it.[77]

The second type concerns entitlement to maritime areas. Of particular relevance are disputes relating to the right of islands, islets and rocks to a continental shelf and EEZ, in the light of the requirements of the United Nations Convention on the Law of the Sea (UNCLOS),[78] sometimes accompanied by a dispute on title to the island. In this case, the dispute does not concern the exact extent of the maritime zone claimed by a State, but the possibility itself of claiming the zone.[79]

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[74] Ibid.
[75] Ibid.
[76] Enrico Milano and Irini Papanicolopulu, 'State Responsibility in Disputed Areas on Land and at Sea,' ZaöRV (2011)71, <http://www.zaoerv.de/> (Accessed 23 October 2016), at pp.609-610.
[77] Ibid, pp. 609-610.
[78] United Nations Convention on the Law of the Sea (UNCLOS) Article 121(3), 1833 *UNTS* 3 / [1994] ATS 31 / 21 ILM 1261 (1982).
[79] Milano and Papanicolopulu, *supra* note 76, at p.610.

This section highlights a number of disputes relating to Kenya's territory and boundaries, that fall within the two categories as highlighted above. It is, however, important to point out that while there may be some reference to the contents of the disputes, this section is not a discussion about the merits of the disputes but rather about the fiscal implications of the exploration and exploitation of natural resources in the contested territories.

### 2.5.1. Ilemi Triangle (Kenya-Ethiopia) Boundary

The Kenya-Sudan-Ethiopia tri-junctional point is generally known as the Ilemi (Elemi) Triangle.[80] The area is approximately 400 kilometers in triangular radius in three directions from where Kenya, Ethiopia and Sudan borders meet.[81] The area in question is illustrated in the figure below.

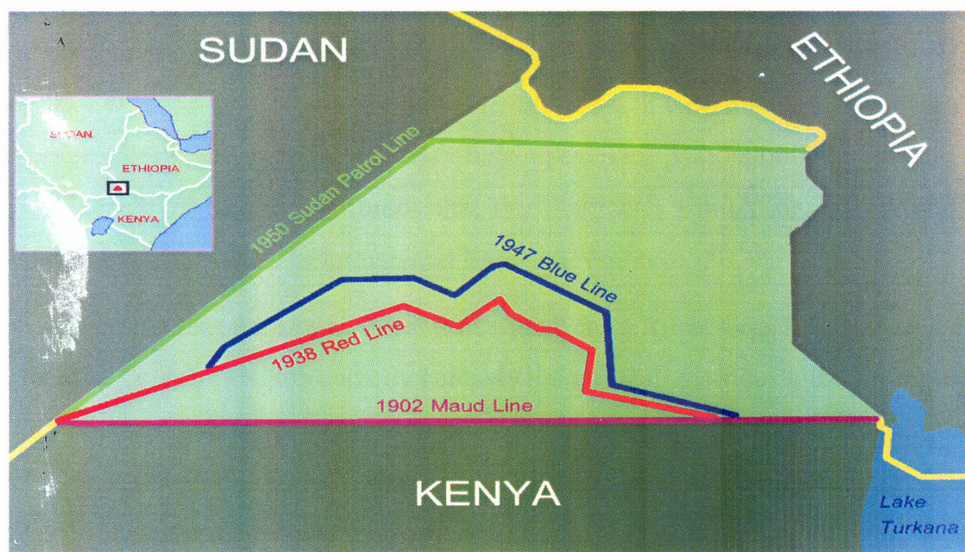


*Figure 2.5.1.1. Disputed Territory 1: The Ilemi Triangle*

Source: © **Wikimedia Commons.**

The highlighted sections are described below:

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[80] Mburu, Nene, "Delimitation of the Elastic Ilemi Triangle: Pastoral conflicts and official indifference in the Horn of Africa." African Studies Quarterly, (2003)(6)4,15, at p.15.
Available at <http://asq.africa.ufl.edu/files/Mburu-Vol-7-Issue-1.pdf≥ (Accessed on 22 October 2016).
The Ilemi Triangle was named after Chief Ilemi (Ilembi, Melile, Chambar) of the Anuak whose village was located on the Sudan bank of the Akobo river near the juncture of the River Ajibur and the Akobo. (Maurice N. Amutabi, 'Land and Conflict in the Ilemi Triangle of East Africa,' Kenya Studies Review, 2010(1)2, 21, at p.23).
[81] Maurice N. Amutabi, above, at p.23.

**Description**: Ilemi triangle (light area), disputed area between Ethiopia, South Sudan (formerly Sudan), and Kenya.

- Red line = established by joint Kenya-Sudan survey team in 1938 as a temporary measure. (also known as wakefield line);
- Blue line = established by Britain's Foreign Office in 1947;
- Sudanese Patrol Line = unilaterally established by Sudan in 1950;
- (Yellow line is country boundaries).

During the partition of Africa, there was no urgency to delimit the Kenya-Sudan-Uganda boundaries, as they were part of the British Empire.[82] Further, the fact that abortive punitive expeditions had indicated that the cost of developing the arid region could not be offset by taxes on the evasive pastoral nomads whose nationality was determined by ecological exigencies such as migration to reduce pressure on exhausted land or escape livestock diseases. Hence, most administrators working in Turkana district were out of touch with the pastoral rhythm of life and needs of the frontier at the grassroots level.[83] Indeed, even the post-colonial governments of Sudan inherited a legacy of negative attitudes that the Ilemi was troublesome, undesirable, and its economic development costly in human and financial resources.[84]

Due to its permanent pasture as a result of waters from River Tarach and other smaller rivers pouring into the Lotagipi swamp and other closely linked smaller swamps, the Triangle was curved out to be a neutral zone by colonial authorities keen to minimize conflict among their African subjects.[85] It was to be a safety net for pastoralist ethnic groups in the surrounding areas who were often engaged in violent conflicts over grazing rights and water during drought. This neutrality was granted after the Kitgum conference resolution of 1924.[86]

The state supervision of territorial boundaries interferes with pastoral survival based on seasonal movement in search of pasture and water. This is how Ilemi Triangle was curved out to avoid conflict over the water and pasture between the various groups in Ethiopia, Sudan and Kenya.[87] Thus, the Toposa (Sudan), the Merile (or Dassanetch), the Nyangatom and the Tirma

[82] Mburu Nene, *supra* note 80, at p.20.
[83] Ibid., at p. 28.
[84] Ibid, pp. 28-29.
[85] Maurice N. Amutabi, *supra* note 80, at p.23.
[86] Ibid, p.23.
[87] Ibid, p. 26; See also Nene Mburu, *supra* note 80, at p.16.

(Ethiopia) and Turkana (Kenya) were to graze and water their livestock under the supervision of the British authorities in Kenya.[88] Since the Triangle was the first to receive modern arms among African hands, it formed the cradle of rush for arms in the region, and experienced the earliest violent skirmishes.[89]

It is estimated that Ilemi Triangle and its fringe are home to one of the largest concentration of pastoralist economies in the world. Furthermore, most of these pastoralist economies which are found in incredibly rugged terrain, punishing climate and extreme temperatures, vegetation covered with shrubs and needle-sharp thorns, rattle-snakes, centipedes, scorpions and other wild creatures and animals, are interconnected in ways that make nonsense of the so-called international border demarcations to minimize suffering.[90] This makes the pastoralist regions to be less policed and their border areas more porous than other border points in the region. Therefore, despite the existing conflict, there are continuous flows of people, arms and livestock across the borders through raids and smuggling and this has escalated raiding leading into bandit activities.[91] Any rectification of regional boundaries after 1960 has tended to be half-hearted measures that evade the most important issue of the delimitation and administration of the disputed pastures.[92]

### 2.5.2. Migingo Island (Kenya –Uganda) Boundary

Resource-driven conflicts have also emerged around Lake Victoria, over the control of the Migingo Island. The island is occupied by about 500 (estimates vary) people, mostly Kenyans of the Luo ethnic community who are predominantly fishermen.[93] Territorially, the island has been administered by Kenya since 1926 but was recently claimed by Uganda.[94] On 11 May 2009, in an apparent effort to ease the then mounting crisis, Ugandan President Yoweri Museveni conceded that the island was Kenyan, but persisted in the claim that the waters surrounding it belonged to Uganda.[95]

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[88] Maurice N. Amutabi, *supra* note 80, at p.23.
[89] Ibid.
[90] Ibid, p. 26.
[91] Ibid, p.26.
[92] Mburu, Nene, *supra* note 80, at p.29.
[93] Peter Wafula Wekesa, 'Old issues and new challenges: the Migingo Island controversy and the Kenya–Uganda borderland,' Journal of Eastern African Studies, 2010(4)2, 331.
[94] Ibid., at p. 331.
[95] Ibid., at p. 331; See also Emmanuel Kisiangani, 'Dispute Over Migingo Escalates,' Institute for Security Studies, Available at https://www.issafrica.org/iss-today/dispute-over-migingo-escalates (Accessed on 26/10/2016).

The dispute as to ownership of the Island has further been exacerbated by the decline of fish primarily because of the creeping problem of the water Hyacinth and population pressures, the three states are increasingly being forced to institute more restrictive maritime controls on the exploitation of its resources.[96] Since Kenya owns only a small portion of the lake, Kenyan fishermen have habitually fished in Ugandan and Tanzania waters, igniting violent confrontations between them and Ugandan and Tanzanian maritime authorities.[97] Kenya also has contested a number of islands inhabited by fishermen which Uganda claims are part of its territory. Uganda's claim on Migingo Island has caused considerable strains between Kampala and Nairobi and is the subject of ongoing demarcation by both sides.[98]

The formative Kenya Uganda border demarcations were made by the British way back in 1926, and had not raised any particular issues with regard to Migingo until 2008 -a fact that suggests current issues may be more important than are historical questions.[99] Further, the available sources on the history of the island indicate that Migingo was first inhabited only in 1991. Contestation over the ownership of the island only came to the fore in June 2004, when the Ugandan marine police landed on Migingo, pitching a tent and hoisting the Ugandan flag.[100] By then, Migingo had become a central base for the burgeoning fishing industry in this north-east sector of Lake Victoria. The Migingo confrontation is believed to be about fisheries, and specifically, about the cause of the lake's declining fish stocks.[101]

Other conflicts over the use of Lake Victoria have emanated from the arrest of many Kenyan fishermen for illegally fishing in foreign waters (waters belonging to Uganda and Tanzania).[102] Once arrested, the fishermen are required to pay a fine and their fishing gear is confiscated.[103] As far as tax jurisdiction is concerned, it has been observed that in an effort to check illegal fishing,

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[96] Gilbert Khadiagala, 'Boundaries in Eastern Africa', Journal of Eastern African Studies, (2010)(4)2, 266 at p. 272.

[97] Ibid., at p. 272; See also Daniel Howden, 'Migingo: Big trouble on small island,' *Independent*, London, Monday 23 March 2009. Available at http://www.independent.co.uk/news/world/africa/migingo-big-trouble-on-small-island-1651736.html [Accessed on 25/10/2016].

[98] Ibid., at p. 273.

[99] Peter Wafula Wekesa, *supra* note 93, at p.335.

[100] Ibid., at p. 335; Muliro Telewa, 'Kenyan anger as Uganda nets island,' BBC News, Thursday, 27 November 2008. <http://news.bbc.co.uk/2/hi/africa/7729842.stm> (Accessed on 26 October 2016).

[101] Peter Wafula Wekesa, *supra* note 93, at p. 335; See also Omondi Eunice Atieno, 'Environmental Scarcity and Trans-Boundary Conflicts: The Case Of Lake Victoria, 1994 – 2011,' October 2014. A Research Project Submitted in Partial Fulfillment for the Award of The Degree of Master of Arts in International Conflict Management to the Institute of Diplomacy and International Studies (IDIS), University of Nairobi. Available at <http://erepository.uonbi.ac.ke/xmlui/bitstream/handle/11295/74620/Atieno_Environmental%20Scarcity%20and%20Trans-boundary%20Conflicts-%20the%20Case%20of%20Lake%20Victoria,%201994%20-%202011.pdf> (Accessed 26 October 2016].

[102] See Gilbert Khadiagala, *supra* note 96.

[103] Peter Wafula Wekesa, *supra* note 93, at p.336.

the three countries did initiate a fishing revenue tax,[104] but the poor administration of this initiative appears to have only worsened the tensions. Indeed, the flare up over Migingo in April 2009 arose when the Ugandan authorities sought to remove several Kenyan fishermen from the island for failure to pay fishing fees.[105] It has been reported that fishermen are willing to pay official fees and taxes for cross-border fishing and fish trade, but they believe that levies on fish should be paid to the country owning the fishing grounds where the fish has been caught.[106] There is, however, a wide spread of perception among fishing communities that government taxing authorities are mainly interested in extracting revenue from landing sites, rather than in enforcing existing rules and regulations to protect and develop the fishery.[107]

It has been observed that while the Kenyan authorities have assumed a diplomatic stance to the crisis, treating the affair as ''a non-issue'', the Ugandan authorities have been more proactive, perhaps because they believe their sovereignty to be directly under threat.[108] Uganda has engaged violent measures including evicting the Kenyan administration police who were resident on the island, evicting Kenyan fishermen who refused to pay fishing fees imposed by Uganda to the tune of 50,000 Uganda shillings (about $ 26), and annual boat licensing fees of 150,000 Uganda shillings (about $ 78).[109] Other atrocities committed by Ugandan Authorities include arbitrary arrests of Kenyan citizens on the island who fail to comply with Ugandan regulations, and imposition of a curfew on the island.[110] The acts by Ugandan authorities amount to harassment and are a clear assault on Kenya's sovereignty.

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[104] Peter Thatiah, '*Kenyan borders under siege*,' published on 15th April 2009, Available at <https://www.standardmedia.co.ke/article/1144011539/kenyan-borders-under-siege> (Accessed 14 December 2017).

[105] Peter Wafula Wekesa *supra* note 103.

[106] Ruraa Ruth, 'Conflict in Cooperation and Its Impact on Regional Peace and Security for the East African Community: A Case Study of the Fishing Industry on Lake Victoria, 1964- 2004, (University of Nairobi, Nairobi, 2005), p.75. <http://erepository.uonbi.ac.ke/bitstream/handle/11295/20269/Ruraa%20Ruth_Conflict%20In%20Cooperation%20And%20Its%20Impact%20On%20Regional%20Peace%20And%20Security%20For%20The%20East%20African%20Community%20A%20Case%20Study%20Of%20The%20Fishing%20Industry%20On%20Lake%20Victoria,%201964-%202004.(3).pdf> (Accessed on 26 October 2016).

[107] Ibid, p.75.

[108] Peter Wafula Wekesa, *supra* note 93, at p. 337; See also Shaka, J., 'Migingo Island: Kenya or Uganda Territory?' Journal of Conflictology, 2013(4)2. <http://journals.uoc.edu/index.php/journal-of-conflictology/article/view/vol4iss2-shaka/v4n2-shaka-en> (Accessed on 26 October 2016).

[109] Peter Wafula Wekesa, *supra* note 93, at p. 336.
See also Elisha Otieno, 'We want to know whether we are Kenyans or Ugandans, Migingo fishermen tell State,' *Daily Nation,* Nairobi, Thursday, April 21, 2016. <http://www.nation.co.ke/counties/migingo-kenya-uganda/1107872-3168376-7uvroj/index.html> (Accessed on 26 October 2016).

[110] Ibid., at p. 337; See also Wafula Okumu 'Resources and border disputes in Eastern Africa,' Journal of Eastern African Studies, 2010(4)2, 279.

These acts by the Ugandan Authorities may also be said to be a breach *jus ad bellum* rules, recognised under United Nations Charter[111] and customary international law,[112] which prohibit States from resorting to violence[113] or to coercing the neighbouring states into a settlement of the maritime boundary with its neighbour into a settlement of the maritime boundary in a bid to protect a disputed territory.[114]

A material distinction is between contested land areas and contested maritime zones. Unlike maritime areas, land is capable of permanent occupation, and will usually be under the effective control of only one State to the dispute.[116] Given this *de facto* situation, it is this State that will materially be able to apply and enforce its legislation with respect to the dispute. The application by the other State of its legislation will be possible in so far as this is permitted without having direct control of the territory.[117] Although maritime zones are not capable of permanent occupation, navigation in them is open to the vessels of all States, including the vessels of the parties to the dispute. It is, therefore, materially possible for both parties to a dispute to apply their legislation therein and to take steps to enforce it in the event of a maritime dispute[118]

Like other border controversies elsewhere in Africa, the Migingo case challenges the perception that border areas are marginal spaces that can be ignored. The Migingo's polemic underscores the reality of the problems arising as a result of the unclear delimitation and demarcation of Africa's frontiers.[119] These disputes impede economic, social and cultural relations across adjacent states thus impeding growth of trade in the continent.

### 2.5.3. North-East (Kenya-Somali) Boundary

On 28th August 2014, the Federal Republic of Somalia instituted proceedings against the Republic of Kenya before the International Court of Justice (ICJ), the principal judicial organ of

[111] United Nations Charter, 26 June 1945, San Francisco; UKTS 67 (1946); Cmd. 7015; 1 UNTS, Article 2(4). The rule against use of force is regarded as a norm of a norm of *jus cogens,* or peremptory norms, that is principles against which derogation is not allowed.
[112] Malcolm N. Shaw, *supra* note 1, at p.490.
[113] Milano and Papanicolopulu, *supra* note 76, at p.597.
[114] Ibid., at p.622.
[116] Ibid.
[117] Ibid.
[118] Ibid.
[119] Peter Wafula Wekesa, *supra* note 93, at p.331; See also Apya, Nongonan Hyacinth, 'Historical Perspectives in the Nigeria Cameroon Border Conflicts (1913 – 2002): Implications on Peace in Africa,' Historical Research Letter, (2014)13. <www.iiste.org/Journals/index.php/HRL/article/download/15479/15887> (Accessed 26 October 2016).

the United Nations, with regard to "a dispute concerning maritime delimitation in the Indian Ocean".[120] In its Application, Somalia contends that both States "disagree about the location of the maritime boundary in the area where their maritime entitlements overlap", and asserts that "[d]iplomatic negotiations, in which their respective views have been fully exchanged, have failed to resolve this disagreement".[121] Somalia requests the Court "to determine, on the basis of international law, the complete course of the single maritime boundary dividing all the maritime areas appertaining to Somalia and Kenya in the Indian Ocean, including the continental shelf beyond 200 [nautical miles]". Somalia further asks the Court "to determine the precise geographical co-ordinates of the single maritime boundary in the Indian Ocean".[122]

In the view of the Applicant, the maritime boundary between the Parties in the territorial sea, the EEZ and continental shelf should be established in accordance with, respectively, Articles 15, 74 and 83 of the United Nations Convention on the Law of the Sea (UNCLOS).[123] Somalia explains that, accordingly, the boundary line in the territorial sea "should be a median line as specified in Article 15, since there are no special circumstances that would justify departure from such a line" and that, in the EEZ and continental shelf, the boundary "should be established according to the three-step process the Court has consistently employed in its application of Articles 74 and 83".[124]

Somalia asserts that "Kenya's current position on the maritime boundary is that it should be a straight line emanating from the Parties' land boundary terminus, and extending due east along the parallel of latitude on which the land boundary terminus sits, through the full extent of the territorial sea, EEZ and the continental shelf, including the continental shelf beyond 200 [nautical miles]".[125]

However, pursuant to Article 79(1) of the Rules of Court, the Republic of Kenya ("Kenya") has since submitted Preliminary Objections to jurisdiction and admissibility of the case concerning

[120] International Court of Justice, *Somalia institutes proceedings against Kenya with regard to "a dispute concerning maritime delimitation in the Indian Ocean"*, Press Release No. 2014/27, 28 August 2014, p.1. <http://www.icj-cij.org/docket/files/161/18360.pdf> (Accessed on 22 October 2016).
[121] Ibid., para. 17.
[122] Ibid., paras. 36 & 37.
[123] UNCLOS, *supra* note 78.
[124] ICJ, *supra* note 119, at para. 34.
[125] Ibid., para. 19.

*Maritime Delimitation in the Indian Ocean (Somalia v Kenya)*, instituted at the ICJ through the Application of the Federal Republic of Somalia ("Somalia") dated 28 August 2014.[126]

Kenya argues that they have expressly agreed on a method of settlement other than the Court for delimitation of their maritime boundary. Allegedly, Kenya's acceptance of the Court's jurisdiction in its Declaration of 19 April 1965 under Article 36(2) of the Statute of the Court, specifically excludes: *Disputes in regard to which the Parties to the dispute have agreed or shall agree to have recourse to some other method or methods of settlement.*[127] Somalia's case is, in Kenya's viewpoint, outside the jurisdiction of the Court and otherwise inadmissible.

Kenya also argues that in the *Memorandum of Understanding between the Government of the Republic of Kenya and the Transitional Federal Government of the Somali Republic* signed on 7 April 2009 (The MOU), the two Parties agreed to grant to each other "no-objection" in respect of submissions on the outer limits of the continental shelf beyond 200 nautical miles ("NM") to the Commission on the Limits of the Continental Shelf ("CLCS"), and further agreed that the Parties would delimit the full extent of their maritime boundary, both within and beyond 200 NM: a) Only after the CLCS has made its recommendations concerning establishment of the outer limits of the continental shelf; and b) By means of a negotiated agreement, not by recourse to the Court.[128] In the main, Kenya argues that:[129]

a. The dispute before the Court concerns the delimitation of the maritime boundary in the area where Kenya and Somalia's maritime claims overlap;

b. The 2009 MOU was Somalia's first indication, after Kenya's Presidential Proclamation of 1979 (whereby Kenya established a maritime boundary in its Exclusive Economic Zone ("EEZ") at the parallel of latitude), that it considered a maritime boundary dispute to exist with Kenya in this area of overlap;

c. In the MOU, Kenya and Somalia expressly agreed that:

[126] International Court of Justice, *Maritime Delimitation in the Indian Ocean (Somalia v Kenya):* Preliminary Objections of The Republic of Kenya Pursuant to Article 79 Of The Rules of Court, Volume I, 7 October 2015, para. 1. Available at <www.icj-cij.org/docket/files/161/19074.pdf> (Accessed 26 October 2016).

[127] Ibid., para. 2.

[128] Ibid., para. 3.

[129] Ibid., para. 4.

(i) "...each of them will make separate submissions to the Commission on the Limits of the Continental Shelf ... that may include the area under dispute, asking the Commission to make recommendations with respect to the outer limits of the continental shelf beyond 200 nautical miles without regard to the delimitation of maritime boundaries between them. The two coastal States hereby give their prior consent [ i.e. under Article 5(a), Annex I, of the CLCS Rules of Procedure] to the consideration by the Commission of these submissions in the area under dispute";[130]

(ii) "The delimitation of maritime boundaries in the areas under dispute, including the delimitation of the continental shelf beyond 200 nautical miles, shall be agreed between the two coastal States [i.e., Kenya and Somalia] on the basis of international law after the Commission has concluded its examination of the separate submissions made by each of the two coastal States and made its recommendations to two coastal States concerning the establishment of the outer limits of the continental shelf beyond 200 nautical miles";[131] and that

(iii) "This Memorandum of Understanding shall enter into force upon its signature".[132]

The other ground of objection by Kenya is that Somalia's Memorial admits that the MOU did in fact enter into force upon its signature by the Parties on 7 April 2009. It asserts however that it is "non-actionable" because the Somali Federal Parliament had "decided against its ratification". Kenya argues that there is clearly no requirement of ratification under the MOU, and Somalia does not explain how such an alleged requirement suddenly appeared after its entry into force. Both the Head of State and the Head of Government of Somalia approved the MOU prior to its signature. Furthermore, subsequent to its signature, the Somali Head of Government twice confirmed its validity, including after its registration and publication by the UN Secretary-General in accordance with Article 102 of the UN Charter. Thus, according to Kenya, there can be no doubt that the MOU continues to be legally binding.

[130] Ibid., fourth operative paragraph.
[131] Ibid., fifth operative paragraph.
[132] Ibid., sixth operative paragraph.

Kenya also asserts that Somalia's initiation of this proceeding before the Court is in plain violation of its obligations under the MOU to negotiate an agreement following CLCS review. It is also in plain disregard of the fact that this agreement on the method of dispute settlement falls squarely within the reservation in Kenya's Declaration. Accordingly, contrary to Somalia's assertion that "[t]he jurisdiction of the Court, in regard to these matters, is plainly established on the basis of Declarations made by the Parties under the optional clause contained in Article 36, paragraph 2", Kenya's reservation categorically excludes this case in its entirety from the jurisdiction of the Court. In addition to Kenya's reservation, Somalia's case is inadmissible because recourse to the Court is in plain breach of the agreed method of dispute settlement under the MOU, which obligation Somalia must perform in good faith.[133]

Somalia also responded to Kenya's Preliminary Objection.[134] It argues that in challenging the Court's jurisdiction to hear its Application, Kenya seeks to foreclose any possibility of an independent determination by the Court of the Parties' maritime boundary in accordance with international law. It thereby endeavours to perpetuate a *status quo* that is characterised by Kenya's marked departure from its previous recognition of an equidistant maritime boundary; its expansive and novel claim to a straight boundary along a parallel of latitude; and its extensive unilateral activities throughout the disputed area. They argue that Kenya's position regarding the location of the maritime boundary is legally untenable and its unilateral activities are a violation of Somalia's sovereign rights. It therefore serves Kenya's interests to oppose the Application is aimed at preventing the merits of Somalia's claims from receiving independent judicial appraisal. According to Somalia, this is the true purpose of Kenya's Preliminary Objections. Somalia further argues that Kenya's reliance on the MOU in an effort to oust the jurisdiction of the Court is allegedly misconceived and entirely without merit. The Preliminary Objections are a transparent attempt to insulate Kenya's unlawful conduct from legal scrutiny. Their position is that there is no obstacle to the Court's ability to hear the merits of Somalia's Application in its entirety, and Somalia invites the Court to firmly so rule. The Court concluded the public hearings in respect of the preliminary objections raised by Kenya on 23rd September 2016 and thereafter started its deliberations on the issues. The Case is still ongoing.

[133] Ibid., paras. 6 & 7.

[134] International Court of Justice, *Maritime Delimitation in the Indian Ocean (Somalia v Kenya):* Written Statement of Somalia Concerning the Preliminary Objections of Kenya, Volume I, 5th February, 2016. <www.icj-cij.org/docket/files/161/19076.pdf> [Accessed on 22/10/2016]. (Somalia's response to Kenya's Preliminary Objection).

The area in the territorial waters in dispute holds a lot of potential as far as oil exploration and mining activities are concerned. Notably, Kenya has already awarded some of its petroleum blocks in the overlapping disputed area to potential investors for oil exploration. This area is demonstrated in the figure below:

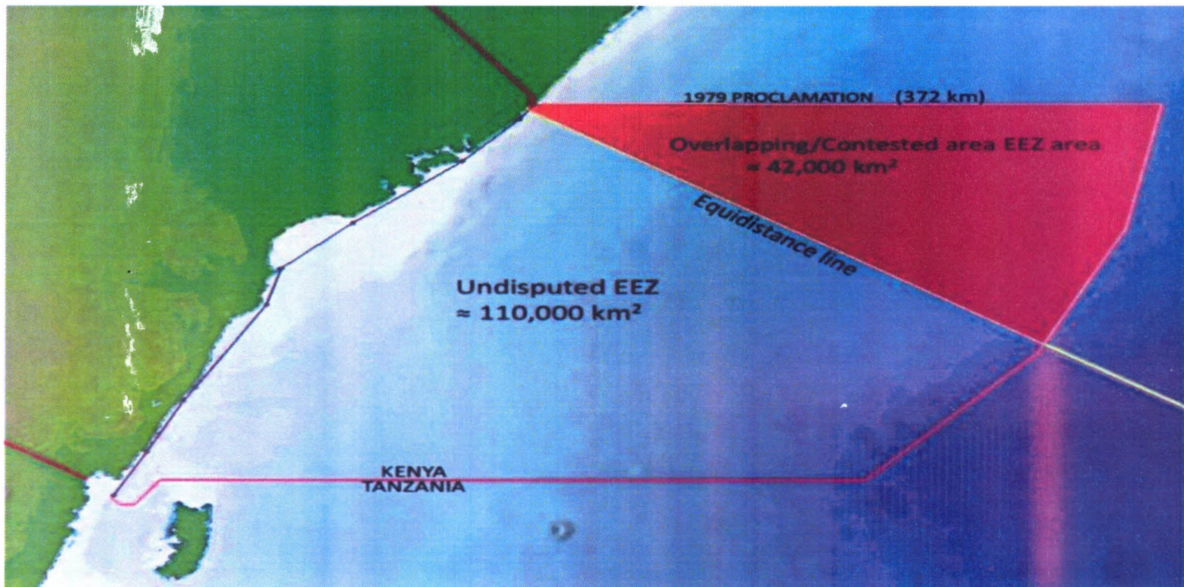
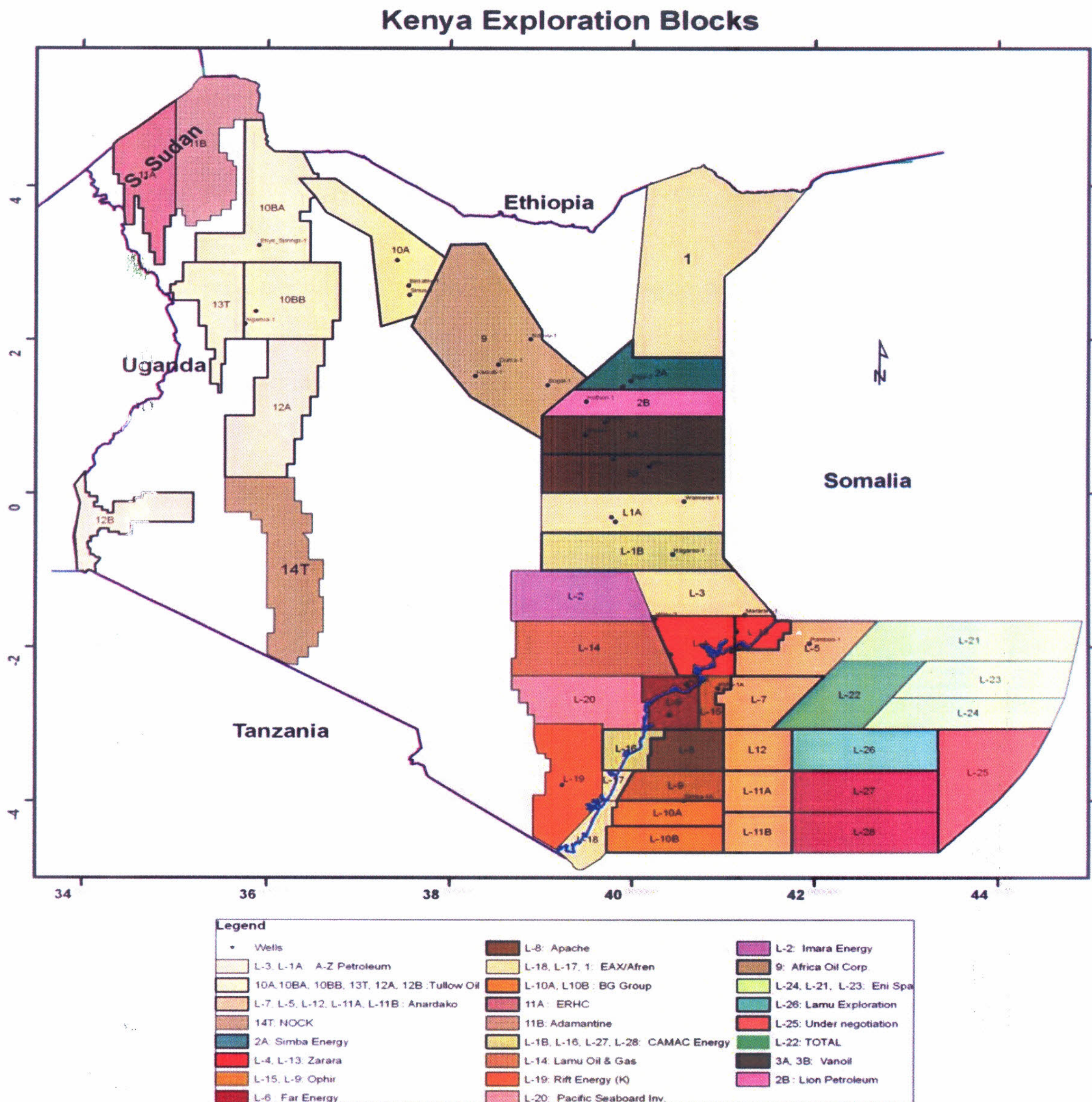



*Figure 2.5.3.1. Disputed territory at the north-east Coast of Kenya*

Source: © **The Star Newspaper (Nairobi, 17 September 2016).**[135]

[135] Emmanuel Wanjala, 'Kenya to defend itself before ICJ on maritime boundary dispute with Somalia,' The Star (Nairobi, 17 September 2016). Available at <http://www.the-star.co.ke/news/2016/09/17/kenya-to-defend-itself-before-icj-on-maritime-boundary-dispute-with_c1422069> (Accessed 22 October 2016].

*Figure 2.5.3.2. Exploration Block Map of Kenya*




Source: © **Government of Kenya Revised Edition 2006.**

It is worth pointing out that the exploration blocks L-5, L-21, L-23, L-24 and L-25 all fall within the contested area, as demonstrated in the above figure. Somalia argues that the blocks lie entirely or predominantly on the Somali side of provisional equidistance line. This has tax implications on the income accruing from any oil from such blocks especially if mining activities commence before the dispute is resolved. The issue has political and financial interests that may

lead to a protracted legal battle before the issue is properly resolved. This is especially so in the wake of allegations that some Western and Gulf oil investors may have convinced the Somali Parliament and top politicians to claim the territory and also that some senior Kenyan officials may be colluding with the Somalis by providing them with insider information that strengthens the ICJ case and any diplomatic negotiations.[136] Indeed, it has been suggested that the Kenya-Somalia dispute is over resources within and beneath the ocean floor, and that unstated in the dispute is the desire to license oil/mineral prospecting firms as a source of revenue, to be supplemented by potentially new discoveries.[137] Such resources come with tax obligations and are this makes the whole debate relevant to this discourse.

### 2.6. Comparative analysis: Iowa v. Illinois boundary dispute

Territorial disputes giving rise to inter-state or intra-state conflicts as to jurisdiction to tax are not exclusive to Kenya. In **Iowa v. Illinois**,[138] in 1839, a protracted territorial dispute arose between the States of Iowa and Missouri over a 9.5-mile border between the two States, as a result of imprecise expression of the term boundary in the Constitution of Missouri Constitution. The dispute, which was finally put to rest by the Supreme Court of United States in the favour of the state of Iowa gave rise to a number of conflicts with regard to exercise of jurisdiction on the disputed area, particularly with respect to the issue of collection of taxes in light of commission of some illegalities such as the incarceration of a Sheriff from Missouri who went on to collect taxes in Iowa.[139] Some notable scholars are of the opinion that the Sheriff should not have proceeded to collect taxes when the question of which state had the requisite legal jurisdiction on the disputed areas remain unresolved.[140] The dispute, may be adequately categorized as following under the rubric of residence-residence type of dispute as observed in the following excerpt:

> But on Feb. 16, 1839. Missouri showed it wasn't willing to wait for Congress to declare what the state boundary was. The Missouri Legislature passed an act declaring that the

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[136] Isaac Ongiri, 'Urgent talks as Somalia claims Kenya coast,' *Daily Nation*, Nairobi, Saturday September 13, 2014. Available at <http://www.nation.co.ke/news/Somalia-Kenya-Indian-Ocean-Claim-Territory/1056-2452028-o0wwmiz/index.html> (Accessed on 22 October 2016).

[137] Hussein Farah, 'Why Somalia has to withdraw case against Kenya at the ICJ?' Horseed Media, July 31, 2015. Available at <https://horseedmedia.net/2015/07/31/why-somalia-has-to-withdraw-case-against-kenya-at-the-icj/> (Accessed on 22 October 2016).

[138] *Iowa v. Illinois*, 147 U. S. 1 (1893).

[139] Ibid

[140] Carroll J. Kraus, '*A Study in Border Confrontation: the Iowa-Missouri Boundary Dispute*' The Annals of Iowa [1969] 40(2), at p.107 Available at <http://ir.uiowa.edu/cgi/viewcontent.cgi?article=7929&context=annals-of-iowa> (Accessed on 14 December 2017).

> jurisdiction of the state extended to the line surveyed by Brown in 1837. That action escalated the dispute and set the stage for the square-off late in the year which almost brought Iowans and Missourians to war. **In the aftermath of the law, officers of Clark County, Mo., immediately south of Van Buren County, Iowa, began to assess and attempt to collect taxes in the area north of Sullivan's line and south of Brown's line, and the effort met with immediate resistance from residents of the area who considered themselves residents of the Territory of Iowa, not of the State of Missouri.**[141] [Emphasis supplied]

It is evident from the foregoing observation, that international disputes are not resolved through national courts of one sovereign state or by one state asserting its laws over the other sovereign state. It is on this account that the research suggests, as part of the recommendations, that there is need to conclude DTAs, bilateral or multilateral, to amicably manage the present disputes on collection of tax and imposition of levy especially along the Migingo island boundary dispute between Kenya and Uganda. The other proposed solution is the negotiation of new treaties establishing frontiers of Kenyan Territory to avoid the problem of unilateral exercise of sovereignty by one state over another state in contravention of the international legal principle of territorial integrity as espoused in the UN Charter.[142]

## 2.7. Conclusion: Implications of Unascertained Territory for Income Taxation

It has rightly been pointed out that increasing expenditures and fiscal constraints, push governments to raise through taxation as much revenue as is possible taxes serve as the primary means for financing public goods such as security,[143] education,[144] health to its citizens,[145] public infrastructure, and maintenance of law and order and public infrastructure[146] These are paramount needs which when effectively fulfilled, help place a state on a global platform in terms of competitiveness, progress, and development.

This, therefore, means that the commercial exploitation of all the natural resources to be found within the country's territory is vital in order to maximise on tax collection. As had been rightly

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[141] Ibid., at p.88.
[142] United Nations Charter *supra* note 10, Article 2(4).
[143] Ben Sihanya, 'Devolution and education law and policy in Kenya' (Kenya Human Rights Commission (KHRC) workshop on Devolution in Kenya, Palacina Hotel, Nairobi, August 2013). <www.innovativelawyering.com/attachments/article/19/Devolution%20and%20education%20law%20and%20policy%20in%20Kenya%20working%20draft.pdf> (accessed 3 March 2016).
[144] Ibid.
[145] Ibid.
[146] 'Chapter 2: Fundamental principles of taxation,' in *Addressing the Tax Challenges of the Digital Economy,* (OECD, 2014), p. 30.

observed in Chapter one, disputes as to territories rob States of their right to control their subjects and property and only serves to cause erosion of the tax base of the State concerned.

As already highlighted elsewhere, some of the existing boundary disputes have been renewed as a result of new discovery of existence of natural resources, making it a fight for the control of such territories and resources, in order to reap the economic benefits that accrue from their exploration and exploitation.[147] Such disputes are not limited to the African region only. For instance, in February 2004, Guyana instituted arbitration proceedings concerning the delimitation of its maritime boundary with Suriname,[148] and concerning alleged breaches of international law by Suriname in disputed maritime territory pursuant to Articles 286 and 287 of the UNCLOS Convention and in accordance with Annex VII of the Convention. The Tribunal was supposed to address the delimitation of the territorial seas and the single maritime boundary dividing the continental shelves and the EEZs of the Parties. The case mainly concerned the right to explore and exploit the resources found within the contested area. While a more critical review of the merits of the case is beyond this discourse it is important to highlight what some aspects of the Tribunal's decision.

The Arbitral Tribunal observed that Guyana had been preparing exploratory drilling for some time before the incident leading to the arbitration, and should have, in the spirit of co-operation, informed Suriname directly of its plans. This was necessary in order to meet its obligation under UNCLOS Convention.[151] According to the Tribunal, some of the steps Guyana could have taken consistent with efforts to enter into provisional arrangements included (1) giving Suriname official and detailed notice of the planned activities, (2) seeking cooperation of Suriname in undertaking the activities, (3) offering to share the results of the exploration and giving Suriname an opportunity to observe the activities, and (4) offering to share all the financial benefits received from the exploratory activities.[152]

The Tribunal also had to deal with the question on whether a party engaging in unilateral exploratory drilling in a disputed area falls short of its obligation to make every effort, in a spirit

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[147] OilInUganda, 'Oil fuels border disputes over Lake Malawi and Ilemi Triangle,' Thursday, 4th October 2012, available at http://www.oilinuganda.org/features/international/oil-fuels-border-disputes-over-lake-malawi-and-ilemi-triangle.html (Accessed 24 October 2016); See also Peter Purcell, 'Myths of oil riches drive resource conflict,' Horn of Africa Bulletin, (2014)(26)4, at p.5. <http://dspace.africaportal.org/jspui/bitstream/123456789/35924/1/HAB_4_2014.pdf> (Accessed 24 October 2016).

[148] United Nations, *Award in the arbitration regarding the delimitation of the maritime boundary between Guyana and Suriname, Award of 17 September 2007*, Permanent Court of Arbitration, Volume XXX, 2012, pp.1-144.

[151] UNCLOS, Articles 74(3) and 83(3).

[152] Guyana/Suriname Award, *supra* note 142, at para. 447.

of understanding and cooperation, not to hinder or hamper the reaching of the final agreement on delimitation. *They ruled that unilateral acts that cause a physical change to the marine environment will generally be comprised in a class of activities that can be undertaken only jointly or by agreement between the parties. This is due to the fact that these activities may jeopardize or hamper the reaching of a final delimitation agreement as a result of the perceived change to the status quo that they would engender.* Indeed, such activities could be perceived to, or may genuinely, prejudice the position of the other party in the delimitation dispute, thereby both hampering and obstructing the reaching of a final agreement.[153] However, they were categorical that this is not to say that all exploratory activity should be frozen in a disputed area in the absence of a provisional arrangement.[154] It has been observed that a State may incur international responsibility upon breaching the sovereignty or sovereign rights of another State in by exploiting resources within the areas yet to delimited and demarcated, pending final delimitation of the maritime boundary aimed at reconciling competing interests of the disputing States[155] Milano & Irini have highlighted a theoretical yet possible scenario:

> A State may grant licenses for the exploration or exploitation of resources in an area that it considers as its own, but where no agreed boundary exists. Will it be responsible for exploring/exploiting resources that are not its own? What if the company carrying out such activities is hampered by the navy of another State, which also claims that the area falls under its own jurisdiction? Will the latter State be responsible for intervening in an area that is not its own?[156]
>
> A second critical scenario arises in cases in which scientists carry out scientific research in a disputed area on the basis of an authorisation obtained by one of the claimant States. If the other State hampers such activities claiming that it has not granted permission for scientific research in its own maritime areas, will the first State be responsible for authorising scientific research in maritime areas that do not fall under its jurisdiction? [157]

The latter scenario is especially possible in the current dispute between Kenya and Somalia considering that Kenya is said to have already licensed and allocated to multinational oil mining companies some offshore petroleum oil blocks for exploitation located within the contested maritime area for oil prospecting. *(See figure 2.5.3.2 above).*

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[153] Ibid, para. 480.
[154] Ibid, para. 481.
[155] Milano and Papanicolopulu, *supra* note 76, at p.629.
[156] Ibid., at pp.629-630.
[157] Ibid.

If Somalia's case were to succeed, it would mean that Kenya will lose out on the potential revenue from the mining activities in the particular area if the oil mining flourishes. In the event the two States agree to compromise on their interests in consideration of the already ongoing oil prospecting. In the *Guyana/ Suriname Arbitration*,[158] the Arbitral tribunal pointed out that joint exploitation of resources that straddle maritime boundaries has been particularly encouraged by international courts and tribunals. The Tribunal made reference to the *Eritrea/Yemen*[159] arbitration opined that although no mineral resources had yet been discovered in the disputed waters, the parties "should give every consideration to the shared or joint exploitation of any such resources."

Reference can also be made to the first boundary treaty between Chile and Bolivia concluded in 1866, delineating the boundary as lying along the parallel at 24 degrees north latitude, but with the two countries sharing the tax revenues on mineral exports from the area between 23 degrees and 25 degrees north latitude.[160] A second treaty concluded in 1874 superseded the 1866 treaty, and entitled Bolivia to collect full tax revenue between the 24th and 25th parallels, but fixed the tax rates on Chilean companies for 25 years.[161] Sometime later, a discovery was made as to the existence of minerals, mainly nitrates (guano and saltpeter) and copper. Guano was used as fertilizer, and saltpeter was used as a component of gunpowder. Chilean companies were increasingly moving into these extractive activities, with the support of foreign interests, notably the British.[162] In 1878, the Bolivian government decreed a tax increase on the companies, which was to be enforced retroactively; meaning the increase in tax would be backdated to 1874. The leading Chilean company refused to pay, and the Bolivians threatened to confiscate its property. In response to this situation, Chile sent a warship to the area. Later that year, the Bolivians announced they would seize the company's assets and auction them early the following year. Chile responded by declaring that such action would render the border treaty invalid.[163]

So important is the concept of certainty that Adam Smith[164] regarded it to be a maxim or principle of tax. A paragraph from his book, *The Wealth of Nations* reads as follows:

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[158] Para. 463.
[159] *Eritrea v Yemen, Award on Territorial Sovereignty and Scope of the Dispute,* (1998) XXII RIAA 211, (1999) 119 ILR 1, (2001) 40 ILM 900, ICGJ 379 (PCA 1998), 9th October 1998, Permanent Court of Arbitration [PCA].
[160] The Carter Center, 'Approaches to Solving Territorial Conflicts: Sources, Situations, Scenarios, and Suggestions,' May, 2010, p.36.
[161] Ibid.
[162] Ibid, p. 36.
[163] Ibid.
[164] A Scottish economist.

> The tax which each individual is bound to pay, ought to be certain and not arbitrary… The uncertainty of taxation encourages the insolence, and favours…corruption... The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that **a very considerable degree of inequality,** it appears, I believe, from the experience of all nations, **is not near so great an evil as a very small degree of uncertainty**.[165] [Emphasis mine].

It is therefore desirable that Kenya endeavours to find a permanent solution to the boundary disputes so that taxpayers are certain as to the extent of their tax obligations.

[165] Adam Smith, *The Wealth of Nations supra* note 24, at pp. 1434-5.

# CHAPTER THREE: CONCLUSION AND RECOMMENDATIONS

## 3.1. Conclusion: Evaluation of Research Objectives, Hypotheses and Research Questions

This research set out to fulfil certain objectives, test certain hypotheses, and answer several research questions in the study of the implications of territorial jurisdiction for international taxation. The three critical tenets of the research centered around the following issues: the effect of Kenya's unclear boundaries with Ethiopia, Uganda and Somali along the Elemi triangle, Migingo Island and the north-east Coast respectively on Kenya's jurisdiction to tax; methods of establishing liability to tax persons living in the disputed territories and income accruing from economic activities undertaken within the disputed boundaries; effectiveness of Kenya's legal framework on taxation of cross-border income; and examination of the role of DTAs as mechanisms for the diplomatic resolution of conflicts emanating from jurisdiction to tax.

It has been established that unclear boundaries limit a state's sovereignty and its right to control a disputed territory. As a result, it greatly hinders the authority of a state to tax residents or income accruing from economic activities carried out in the disputed areas because it renders it difficult to establish residence and source for purposing of asserting personal and territorial jurisdiction to tax respectively.

The determination of liability to tax persons living in the disputed territories and income accruing from economic activities undertaken within the disputed boundaries depends on the rules or criteria expressed either in the state's national law or in international law establishing liability to tax. The supremacy of either national or international law depends on whether a state is monist or dualist. Kenya is a monist state.[1] Tim Hiller opines that monism propounds the argument that international law and national law are part of the same body of law and operate on the same sphere.[2] Courts in monist systems apply international law directly once ratified. The Constitution of Kenya under Article 2(5) and (6) recognises that general rules of international law and any treaty or convention ratified by Kenya form part of Kenya law.[3] The Treaty Making and Ratification Act 2012 gives effect to the provisions of Article 2(5) and (6) by providing for the process of ratification. Parliament does not have the power to 'domesticate' treaties once ratified.[4] From the

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[1] Peter Kirimo, 'The Place of International Law Under The 2010 Constitution of Kenya in Relation to Article 2(5) and (6),' LLB dissertation available at <www.academia.edu/8668891> (accessed 13 May 2016).

[2] Tim Hiller, *Principles of Public International Law* (2nd edn, Cavendish Publishing Ltd, New York, 1999) p.5.

[3] The Constitution of Kenya, (Government Printer, Nairobi, 2010).

[4] Maurice Oduor, 'The Status of International Law in Kenya,' African Nazarene University Law Journal (2015)(2)2, <http://ssrn.com> (accessed 13 May 2016), at p. 97.

above constitutional and statutory provisions, it is evident that Kenya has fully embraced monism insofar as international law is concerned.

In the realm of commerce and trade, issues and disputes involving tax between and among various jurisdictions must arise. Such disputes can only be resolved internationally. Recognising international tax Treaties only serves to make favourable the business environment of the persons concerned, natural or juridical. It is the researcher's conclusion that the disputes on territorial boundaries of Kenya will best be resolved through international mechanisms, namely, diplomacy and when it fails, by submitting the disputes to international courts. Diplomacy entails the resolution of disputes through mechanisms such as Alternative Dispute Resolution (ADR).[5] The imminent failure of negotiations between Kenya and Somali concerning the north-east Coast maritime dispute prompted Somali to submit the dispute for resolution to the ICJ.[6] Although the Court is yet to decide the case, it is imperative to state that the Statute of the ICJ clearly lays down the framework through which disputes submitted before it must be resolved.[7] Article 38(1) of the Statute provides in resolution of disputes before it, ICJ shall apply: general or specific international conventions or treaties expressly recognised by the contesting states;[8] customary international law;[9] the general principles of law recognised by civilised states;[10] judicial decisions[11]subject to the provisions of Article 59,[12] and as subsidiary means for the determination of rules of law, the teachings of highly qualified publicists of various nations.[13]

Territorial and maritime disputes are not a novel occurrence - they have erupted in other states. This means that the boundary disputes between Kenya and the relevant states can also be solved, and that Treaties establishing the disputed boundaries concluded between them, if any, will be considered in the resolution of the disputes.

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[5] The UN Charter, Article 33(1) recognises that settlement of- inter-state disputes may be effected through arbitration, conciliation, enquiry, judicial settlement, mediation, negotiation, resort to regional agencies or arrangements, or other peaceful means of their own choice.

[6] See the Statute of the International Court of Justice, Article 34(1) and Article 36.

[7] Statute of the International Court of Justice contained in the 1945 UN Charter, under Article 38(1).

[8] Ibid., Article 38(1)(a).

[9] Ibid., Article 38(1)(b).

[10] Ibid., Article 38(1)(c).

[11] Ibid., Article 38(1)(d).

[12] Ibid., that decisions rendered by ICJ are not binding upon the parties. But in most cases, the decisions are complied with. Otherwise, the Court would be appear in all fairness to be a toothless bulldog and states would lose confidence in its ability to even render advisory opinion as it is occasionally invited to do, see Statue of ICJ- see Article 65.

[13] Statute of the International Court of Justice, Article 38(1)(d). It is not clear whether the listed sources are listed in a hierarchical order but it can be inferred that judicial decisions and writings of various publicists of the various nations are somewhat inferior to the sources listed prior. See Malcolm Shaw, *International Law* (6th ed, Cambridge University Press, Cambridge, 2008), at pp.123-4.

Double Taxation Agreements fall under Article 38(1)(a) of the Statute of ICJ as a source of law. DTAs are effective mechanisms for the diplomatic resolution of conflicts emanating from jurisdiction to tax and other inter-state tax disputes. They fall within the ambit of the Vienna Convention on the Law of Treaties. Generally, DTAs endeavour to harmonise the rigid and unilateral exercise of sovereignty found in national laws by bilaterally or multilaterally reducing possibilities of double or multiple taxation, tax evasion and other inter-state tax disputes likely to emerge as a result of cross-border and international trade.[14]

### 3.2. Recommendations

The recommendations proposed are anchored in the theoretical framework underpinning the research: the economic efficiency theory and the benefits received theory. Taxes, whether at a national or international level must be capable of being efficiently administered, notwithstanding frontier disputes. It is important that revenue authorities ensure that the taxes levied do not become unfairly burdensome to taxpayers and unfairly beneficial to states at the expense of such taxpayers.[15] In other words, there is need to ensure double or multiple taxation is prevented and tax evasion is curbed for the benefit of both taxpayers and states. Further, in view of the benefits received theory, it is critical that states endeavour to conclude DTAs to ensure that the laws applicable are as nearly similar as possible so that the jurisdiction to tax asserted does not work towards eroding the tax base of another state especially during cross-border and international transactions. This will help ensure that the state which greatly contributed to the generation of the particular income benefits equitably through the taxation of the income as against other states.

Chapter two augmented the need for Kenya to endeavour to find a permanent solution to the boundary disputes in keeping with requirement as to certainty of taxation.[16] On this premise, this research recommends that there is need for:

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[14] Colby Mangels, 'Review of International Commercial Tax by Peter Harris and David Oliver,' Berkeley J. Int'l Law (2014)(32)2. <http://scholarship.law.berkeley.edu/bjil/vol32/iss2/10> (Accessed 15 March 2016), at p.474.

[15] C.J. Bullock (ed), *Adam Smith, The Wealth of Nations* (P.F. Collier & Son, New York, 2001), at p.1437.

[16] Ibid., at pp. 1434-5.

### 3.2.1. Joint Exploitation and Sharing of Benefits Accruing from Resources within Disputed Territories

In addressing the question of joint exploitation and sharing of benefits accruing from resources within disputed territories, the ICJ noted in the *North Sea Continental Shelf* cases,[17] that state practice indicates that when dealing with deposits straddling a boundary line, States should undertake to negotiate agreements with a view to ensuring the most efficient exploitation or apportionment of the accruing economic benefits. The Court emphasised that agreements for the joint exploitation of resources in disputed territories of States were particularly appropriate especially where the dispute concern application of conflicting methods of delimitation and demarcation of boundaries.

Kenya and Somalia may consider exploring this option because the two states advocate for different methods of delimitation of maritime boundaries. Somalia has accused Kenya of departing from its previous recognition of an equidistant maritime boundary, by making an expansive and novel claim to a straight boundary along a parallel of latitude. Somalia argues that this method is legally untenable and will result in a violation of Somalia's sovereign rights.[18] In the *Guyana/ Suriname Arbitration*,[19] the Arbitral tribunal pointed out that joint exploitation of resources that straddle maritime boundaries has been particularly encouraged by international courts and tribunals.[20]

In the case of Migingo Island, where, as highlighted before, Ugandan authorities have been harassing and intimidating Kenyan fishermen through arbitrary arrests, coercion to pay taxes in form of fishing fees, and confiscating their fishing gears where they fail to do so requires a prompt and permanent solution to the crises. Kenya and Uganda should also consider the possibility of negotiating an agreement that facilitates the joint exploitation of the resources on the island.

The same solution is also viable for the disputed land along the Ilemi triangle especially because of the news indicating possibility of existence of oil deposits in the triangle.[21] On this

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[17] North Sea Continental Shelf Cases (Federal Republic of Germany/ Denmark and Netherlands) (1969) ICJ Rep 3.
[18] See International Court of Justice, *Maritime Delimitation in the Indian Ocean (Somalia v Kenya):* Written Statement of Somalia Concerning the Preliminary Objections of Kenya, Volume I, 5th February, 2016. <www.icj-cij.org/docket/files/161/19076.pdf> (Accessed on 22 October 2016). (Somalia's response to Kenya's Preliminary Objection).
[19] United Nations, *Award in the arbitration regarding the delimitation of the maritime boundary between Guyana and Suriname, Award of 17 September 2007*, Permanent Court of Arbitration, Volume XXX, 2012, pp.1-144.
[20] Ibid., see para. 463.
[21] Eliza M. Johannes, Leo C. Zulu & Ezekiel Kalipeni, 'Oil discovery in Turkana County, Kenya: a source of conflict or development?' African Geographical Review (2015)(34)2 142, at p. 149; See also Nelson Ijumba & Hassan Kaya, 'Energy Resources and Environmental Conflicts in Africa: Implications on Indigenous Knowledge Systems and Environmental Policy,' J Hum. Ecol. (2016)(53)2 96, at p.97.

account, the need for formal determination of the ownership of the Triangle becomes critical so that the resources within the regions are equitably and sustainably. Additionally, because the Triangle is a land territory, the question of permanent occupation may arise, rendering it difficult to determine source of income or residence of the inhabitants.

### 3.2.2. Conclusion of Bilateral Double Taxation Agreements between Kenya and States Adjacent to its Frontiers

Kenya has currently signed several DTAs with different countries, namely, DTAs between Kenya and: Canada; France; Denmark; German; India; Norway; Sweden; United Kingdom; Zambia; United Arab Emirates; South Africa; Seychelles; and a multilateral one with members of the East African Community (EAC), [22] which is yet to be operational. There is no DTA currently in force between Kenya and the countries with which it is engaged in territorial disputes, namely, Uganda, Ethiopia and Somali. The EAC Double Taxation Agreement is certainly a step in the right direction. Negotiating DTAs with Ethiopia and Somali countries will help foster cooperation in furtherance of cross-border trade with respect to taxation.

It is also observed that DTAs are effective mechanisms for the diplomatic resolution of conflicts emanating from jurisdiction to tax and other inter-state tax disputes. DTAs are regarded as Treaties and, therefore, fall within the ambit of the VCLT. DTAs endeavour to harmonise the rigid and unilateral exercise of sovereignty found in national laws by bilaterally or multilaterally reducing possibilities of double or multiple taxation likely to emerge as a result of cross-border and international trade.[23]

The advantage of DTAs are that they: help avoid double taxation and prevent fiscal evasion; curb discriminatory tax treatment based principals such as National Treatment (NT) and Most Favoured Nation (MFN); encourage foreign investment especially through the provision of tax holidays under tax sparing provisions contained in DTAs; bolster the powers of revenue authorities of the contracting states insofar as collection of taxes is concerned; facilitate uniformity of practice and law on tax among the contracting states thus minimising possibilities of tax disputes and

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[22] East African Community Agreement between The Governments of The Republics Of Kenya, Uganda, Burundi, Rwanda and The United Republic of Tanzania for the Avoidance of Double Taxation and The Prevention of Fiscal Evasion With Respect to Taxes on Income <www.EAC%20double%20taxation%20agreement&oq=EAC%20double%20taxation%20agreement> (Accessed 26 October 2016)

[23] Colby Mangels, *supra* note 14, at p.474.

finally,[24] that DTAs expand the scope of enforcement mechanisms to deal with inter-state tax disputes.[25] On the flipside, DTAs present several disadvantages, most notably, the erosion of tax base of the contracting states especially where one country foregoes its right to tax for another states; DTAs take longer time to negotiate and come into force unlike domestic laws; probability of Treaty override[26] and underride[27] which only serve to defeat the principle of *pacta sunt servanda*[28] and the purpose of the relevant Treaty.[29] In consideration of the growth of cross-border and international commerce, it is imperative that states negotiate DTAs in order to facilitate effective administration of tax in their jurisdictions, which is a key factor taken into consideration by businessmen and investors across the globe.

### 3.2.3. Negotiation of New Treaties Establishing Frontiers of Kenyan Territory

It is in the interests of protecting states from fratricidal fragmentation of their frontiers that bilateral and multilateral Treaties establishing the boundaries of states should be concluded. The Vienna Convention on the Law of Treaties (VCLT) recognises the right of states to conclude treaties,[30] and their duty to refrain from conduct which serves to defeat the object of the Treaties consented to.[31] The duty to refrain from conduct which defeats the object of the Treaties is in keeping with the principle of *pacta sunt servanda*[32] that international agreements or Treaties have a binding force and that the obligations arising thereunder must be performed in *bona fides*. The

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[24] United Nations Model Double Taxation Convention between Developed and Developing Countries (United Nations, New York, 2001) ST/ESA/PADPSER.E.21, see paragraph 34 on the 'Rationale and Significance of the United Nations Model Convention', at p. xx <www.un.org/esa/ffd/wpcontent/uploads/2014/09/DoubleTaxation.pdf> (Accessed 26 October 2016).

[25] Both the 1977 OECD Model Double Taxation Convention and the 2011 UN Model Double Taxation Convention contain a similar provision (Article 25) to guide developed and developing countries respectively as to the mechanism of enforcement or administration of DTAs. The provision, titled 'Mutual Agreement Procedure' sometimes titled 'Administrative Co-operation Clause' in some DTAs, states that persons who consider that the actions of one or another contracting state may occasion taxation inconsistent with the provisions of the Treaty may within 3 years from the date of the action giving rise to the inconsistent taxation, seek redress from the competent authority of the contracting state in which the person is a resident or national, despite the availability of domestic remedies in the other state.

[26] Occurs when one or more states to the DTA amends the relevant Treaty by adding certain provisions to the Treaty.

[27] Occurs where one or more states to the DTA amends the relevant Treaty by failing to undertake certain obligations imposed by the Treaty.

[28] VCLT, *supra* note 14, Article 26 that states to a Treaty are required to perform obligations imposed thereunder in good faith. Further, treaty override and underride is prohibited behaviour by virtue of Article 18 of the Convention because it calls upon states to a Treaty to refrain from conduct which would defeat the object and purpose of a Treaty.

[29] I am grateful to Prof. Arthur Eshiwani (Senior Lecturer at the University of Nairobi-School of Law) for the lecture conducted on Tuesday 5th April 2016 with respect to appraisal of the merits and demerits of DTAs. The advantages have also been expressed in The United Nations Model Double Taxation Convention between Developed and Developing Countries (United Nations, New York, 2011) 6th introductory paragraph, at p. vii. <www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf> (Accessed 26 October 2016).

[30] Vienna Convention on the Law of Treaties, 22 May 1969, 1155 UNTS 331; 8 ILM 679 (1969); 63 AJIL 875 (1969), see Article 6.

[31] Ibid., Article 18, subject to the permissible reservations (see Articles 19-23).

[32] Ibid., Article 26.

binding nature of treaties is further enforced by the rule that Treaties are only regarded as terminated if the state parties conclude another Treaty in respect of the same subject matter.[33] The implication of this rule is that Treaties concluded by Kenya and adjacent states to establish boundaries or lines of delimitation over its land or maritime zones are binding in international law so long as the state parties have not concluded new Treaties to supplant the old ones regarding the same subject matter.

In conclusion, it is imperative to make the unfortunate observation that within the realm of international tax, uncertainty stimulates in the mind the image of a taxpayer crossing his fingers in anticipation of the worst. Certainty facilitates taxpayers to arrange their affairs within the ambit of the law. It also prevents the opportunistic taxman from dipping the largest possible shovel into the pockets[34] of the oblivious taxpayers to their undeserved economic detriment. Simply put, Kenya must endeavour to find a permanent solution as to its frontier disputes in order to establish with certainty the limits of its territorial jurisdiction to tax.

### 3.2.4. Equitable Provision of State Resources to Borderland Communities

Communities living along various state borders are often neglected and marginalised thus motivating them to engage in illicit or illegal trade as a means of livelihood. With the exception of a few such as the United States, most countries do not tax income from illegal trade.[35] They may, however, levy higher Value Added Tax (VAT) for some products in order to discourage certain harmful habits such as alcoholism and smoking. In order to fight criminal activities in the realm of commerce and trade, states must work at ensuring the inclusion of borderland populations in administration of public finance.[36] The inclusion can be done by availing resources and infrastructure that can economically empower such communities to generate income. If the communities reap tangible benefits from the state, then the obligation to pay tax will not be avoided. As rightly observed by Adam Smith, the subjects of every state are under the obligation to contribute towards meeting the cost of government expenditure with regard to their ability to pay, owing to the privilege of protection by the state.[37]

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[33] Ibid., Article 59(1).

[34] See the dictum of Lord Clyde in *Ayrshire Pullman Motor Services v. I.R.C.*, (1920) 14 T.C. 754 at p.763. See also Adam Smith *supra* note 22, at p.1436.

[35] Annette Weber, 'Boundaries with Issues: Soft Border Management as a Solution?' (Friedrich-Ebert-Stiftung Eastern Africa, 2012), at p. 2.

[36] Ibid., at p. 4.

[37] Ibid., at p. 1433-4.

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