TAX ADMINISTRATION REFORMS IN KENYA IDENTIFYING LESSONS TO MODEL A STRATEGY FOR SUSTAINABLE ADMINISTRATION OF COUNTY TAXES

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DECLARATION

This thesis is submitted in fulfilment of the requirements for the award of the degree of Doctor of Philosophy (PhD) in Law of the University of Nairobi. The thesis is my original work and has not been submitted for examination to this or any other University.

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ABSTRACT

The several tax administration reforms undertaken in Kenya do not exhibit a discernible methodology. There is no clear, deliberate and integrated reform mechanism to avoid haphazard implementation of reforms. With this background, implementation of county tax administration is bound to be haphazard, and without measurable expectations. The problems at the national tax administration will inevitably be devolved to the counties. A number of the past tax administration reform efforts have mainly been donor-led (IMF, World Bank, DFID, etc.), largely intended to tackle neopatrimonialism in governance in Kenya, as in the rest of sub-Saharan Africa.

The devolved system of government is a creation of the Constitution of Kenya, 2010. As such, the legal regime for county tax administration is lacking. There is no literature specific to the Kenyan situation. There is no history to learn from. Towards solving the problem, this study conducted research on national level tax administration reform together with insights from other jurisdictions. It also considered the tax administration structures under the previous system of local government. Taxation is largely local and therefore national experiences are better sources of solutions for county taxation than experiences from other jurisdictions.

The reforms at the national level have shown that neopatrimonialism is unlikely to be a key issue in tax administration reform. County tax administration largely deals with property tax and entertainment tax. There is need to take cognisance of the overridding principle contained in Article 209(5) of the Constitution. In the course of formulating a strategy for property tax administration, the sustainability should be tested against the effective rate of property tax (ERPT).

This study has suggested the need to undertake several law reform measures to guide county tax administration reforms. This entails the amendment of the Constitution, the repeal and amendment of several Acts of Parliament, the enactment of a new Act of Parliament, the enactment of several county legislation and the formulation of a specific policy paper. All this should be geared towards administering the subnational taxes in a sustainable manner taking cognisance of the tax culture, with minimal cultural lags and shocks to achieve the intentions of the framers of the Constitution of Kenya, 2010.

Key words: tax administration, tax administration reform, county tax administration, county tax administration strategy

DEDICATION

This work is dedicated to all who are dedicated in making Kenya, and Africa, a better place to live in and achieve what God intended for us. We can achieve anything as long as we believe that change comes from within.

To my youngest son, Radhi Gichuki: some day you'll be old enough to understand what is in here, and you'll do more.

To my wife, Lucy Nyambura Kimani Njaramba as proof that with love everything is possible.

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LIST OF ACRONYMS

<u> </u>
ADB – African Development Bank
AEO – Authorised Economic Operator
ANC – African National Congress (of South Africa)
ARA – Autonomous Revenue Authority
ASYCUDA – Automated System for Customs Data
B2B – Business-to-Business
BOD – Board of Directors
CAMA – Computer-Assisted Mass Appraisal
CBK – Central Bank of Kenya
CCA – Central Collection Agency (of Cleveland, Ohio, USA)
CCRS – Common Cash Receipting System
CED – Customs and Excise Department
CEO – Chief Executive Officer
COMESA – Common Market for Eastern and Southern Africa
DFID – Department for International Development (of UK)
DTD – Domestic Taxes Department

DWBI – Data Warehouse and Business Intelligence

EAC - East African Community

EPA – Economic Partnership Agreement

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- ERPT Effective Rate of Property Tax
- ERS Economic Recovery Strategy
- ESA Eastern and Southern Africa
- ESD Electronic Service Delivery
- ETR Electronic Tax Register
- EU European Union
- FAD Fiscal Affairs Department (of IMF)
- FESD Fiscal Electronics Signature Device
- FGD Focus Group Discussion
- GDP Gross Domestic Product
- GPRS General Packet Radio Service
- HELB Higher Education Loans Board
- IBEA Imperial British East Africa Company
- IBEC Intergovernmental Budget and Economic Council
- ICT Information and Communication Technology
- IEA Institute of Economic Affairs
- IFIs International Financial Institutions
- IFMIS Integrated Financial Management Information System
- IFMS Integrated Financial Management System
- IMF International Monetary Fund

IPRS – Integrated Population Registration System

IRS - Internal Revenue Service (of USA)

ITMS – Integrated Tax Management System

ITN - Individual Taxpayer Number

KLGRP – Kenya Local Government Reform Programme

KRA – Kenya Revenue Authority

KYC - Know Your Customer

LTO - Large Taxpayers Office

MRA – Malawi Revenue Authority

NIDS - National Identification System

NPM – New Public Management

NSSF - National Social Security Fund

OECD - Organization for Economic Co-operation and Development

PAYE - Pay As You Earn

PCA - Post Clearance Audit

PIN - Personal Identification Number

RA – Revenue Authority

RAMS – Rates Administration Management System

RARMP - Revenue Administration Reform and Modernization Programme

RILO - Regional Intelligence Liaison Office

S2005S - Simba 2005 System

SAR – Self Assessment Return

SARS - South African Revenue Service

SUNAT – National Tax Administration Superintendency (of Peru)

TIN - Taxpayer Identification Number

UN-HABITAT – United Nations Human Settlements Programme

VAT – Value Added Tax

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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

Tax administration reforms in Kenya¹ have largely been inconsistent. This can be discerned from the fact that there are no clear rules to show how it has been done. This has a negative socio-economic and political impact. Uncertainty creeps into taxation; the tax burden becomes heavier and compliance levels are affected. Revenue loss becomes the inevitable reality. If this is not addressed, it will negatively impact on the administration of taxes in the counties established in the new devolved system under the Constitution of Kenya, 2010.

Tax administration generally refers to the aspect of "how to do it" in respect of a tax system. It is the mechanisms available for the achievement of "what to do" in respect of the various taxes. It is therefore the means to actualize the tax laws and systems and as such it is important for the achievement of the wider taxation goals. It is therefore distinct from substantive tax law.²

Tax administration is the tool with which tax law and policy is implemented and the means with which governments raise revenue to finance spending on goods and services. It is more to do with the framework that supports day-to-day management of revenue administration and covers systems, structures, management, leadership and organizational processes that enable a tax agency to meet its core mandate. ³

¹ The republic of Kenya is in East Africa bordered by Tanzania, Uganda, Sudan, Ethiopia and Somalia. It gained its independence from Britain on 12th December 1963, having been a British protectorate from 1895 and declared a British colony in 1920. It covers an approximate area of 582,646 sq. km., about 80% of which is arid or semi-arid. Its capital city is Nairobi, which is both an administrative and commercial capital. It is a multiparty democracy since 1992, but with the promulgation of a new constitution on 27th August 2010 the political and administration structure got wide ranging changes. The most prominent is devolution which established two tiers of government, the national government and the counties.

² The term 'distinct' as used here is not intended to create the impression that substantive tax law and tax administration law operate in isolation. Indeed certain tax statutes comprise of both. For instance, the Income Tax Act (Cap. 470) is both a substantive and procedural tax statute.

³ Kenya Revenue Authority (2010) Revenue Administration Reforms in Kenya: Experience and Lessons, Nairobi, p. xvi.

Tax administration reform⁴ therefore plays a key role in the general reform of the tax system. The administrative dimension should therefore be placed at the centre rather than the periphery of tax reform efforts.⁵ It has been suggested that "tax administration is tax policy".⁶ This position flows from the understanding that it is through the administration of taxes that proposed policies are implemented. Conversely, tax policies will not achieve the desired results unless the administration is efficient.

Revenue administration reform is important for a number of reasons. Whereas tax laws create the potential for raising revenues, the actual amounts collected depend to a large extent on the efficiency and effectiveness of the administration. The quality of the administration also influences the investment climate and private sector development in a country. There is a high incidence of corruption in revenue administrations and therefore reform would be needed to curtail this. Reform may also be needed to enable the administration keep up with continuous sophistication of business activity and tax evasion schemes. Indeed a tax system is only as effective as the administrative machinery that implements it.

In many developing countries, tax administration reform has been part of a broader fiscal reform effort aimed at restoring macroeconomic stability and at restructuring tax systems so that taxes are more efficient, less distortionary of market forces and easier to administer. In both developing and developed countries, tax administrators face the challenge of modernizing the tax administration so that it can operate effectively in an increasingly global economy. However, it must be appreciated that

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⁴ Whereas there are various versions of defining the term 'reform', it generally means making changes in something (typically a social, political or economic institution or practice) in order to improve it. Tax reform would then generally mean the process of changing the way taxes are collected or managed by the government (cf. Oxford Dictionary available at www.oxforddictionaries.com).

⁵ Bird, R. M. (1992) *Tax Policy & Economic Development*, The John Hopkins Press, London, p. 189.

⁶Casanegra de Jantscher, M. (1990) "Administering the VAT" in Gillis, M., Shoup, C. S. and Sicat, G. (1990) *Value-Added Taxation in Developing Countries*, World Bank, Washington, p. 277.

⁷ Gill, J. B. S. (2003) The Nuts and Bolts of Revenue Administration Reform, pp. 1-2.

⁸ Fakile, A. S., F. F. Adegbie & O. S. Faboyede (2014) "Mobilizing Domestic Revenue for Sustainable Development in Africa" *European Journal of Accounting Auditing and Finance Research*, Vol. 2, No. 2, pp. 91-108, April, p. 105.

⁹Silvani, C. and Baer, K. (1997) "Designing a Tax Administration Reform Strategy: Experiences and Guidelines," *IMF Working Paper 97/30*, International Monetary Fund, Washington, p. 4.

whereas we operate in a global economy, taxation is still largely a local issue, excepting only the few instances when it acquires an international character such as in the application of double taxation agreements.¹⁰

Limited administrative capacity is a binding constraint on tax reform in many developing countries such as Kenya. There is widespread tax evasion. Even where there is no outright evasion, the tax structure is often designed, administered and judicially interpreted in such a way as to ensure the emergence of a huge gap between the potential and the actual tax base. There is therefore a great discrepancy between what the tax system appears to be on the surface and how it actually works in practice. The patchwork character of the tax system of many developing countries arises in large part from their inability to administer the taxes they legislate, resulting in the continual need to legislate new tax changes. Whereas existing taxes may not be optimally collected, new taxes may be legislated to enhance revenue. This is also attributable to the several "experts" consulted in the process of law reform. The expert's inclination inevitably informs the resultant legislation.¹¹

Tax reform is a political process. Accordingly, understanding the nature of that process is key to understanding what kinds of reforms are possible and what kinds of reforms are not. For decades now, it has been accepted that there can be no taxation without representation. However, meaningful tax reforms may be the product of administrative rather than political leadership. Indeed for purposes of certainty and consistency in taxation, the powers of political leadership over tax administration reform should be limited.¹²

¹⁰ These are agreements or treaties between two taxing jurisdictions relating to how they would share the tax due in instances where both would be entitled to tax under their respective tax laws. The main purpose is to ensure that the taxpayer is not made liable to pay tax in both jurisdictions.

¹¹Bird, R. M. (1992) *supra*, p. 190.

¹²Steinmo, S. (1995)"The Politics of Tax Reform," in Sandford, C. (1995) *More Key Issues in Tax Reform*, Fiscal Publications, Bath, pp. 211-212.

Experts have suggested that the solutions to the administrative problems of tax reform may be divided into three groups:-

a) Those that would change the environment.

This may be done through "tax payer education" to encourage compliance, making fundamental changes in the way government is conducted to encourage a change in attitude to taxation and promote fairness in the tax system which would also be an important factor in shaping attitudes. The political situation in a country also affects the environment. However, it should be understood that since it is not the duty of any taxpayer to assist the tax authorities to get as much tax from him as possible, incentives to encourage compliance and disincentives to discourage non-compliance should be provided and be centrally located in the tax payer education curriculum.¹³

b) Those that would change the administration.

This may be through devising an incentive system for tax administrators. However, the most basic way to ensure that tax officials do what they are supposed to do, and no more, is to reduce to a minimum the amount of discretion they have in dealing with taxpayers. Article 210 of the Constitution of Kenya, 2010, has to a commendable degree reduced the amount of discretion by expressly providing that taxes or licensing fees can only be imposed, waived or varied through legislation.

c) Those that would change the law.

Three ways have been recognized for dealing with the question of modifying the legal structure to accord with the administrative realities of developing countries. To develop some gadgetry to bypass the problem has been considered to be a false lead. For instance, the mere introduction of Electronic Tax Registers (ETRs) cannot be a solution unless the basic tax law is adequate and has proper systems to ensure compliance. To provide an adequate legal structure for administration is obviously important but in itself inadequate. Whereas this is deemed inadequate, it is the key

¹³Bird, R. M. (1992) *supra*, p. 193.

¹⁴*Ibid*, p. 195.

towards achieving the substance of tax laws. To design the basic tax law properly in the first place, is in the end the only sensible procedure.¹⁵

Whereas the importance of designing proper basic tax law¹⁶ cannot be gainsaid, the yield of the tax system will eventually depend on the structures in place to implement such a law. This is why tax administration is the driving cog in taxation.

There are three basic rules of reform. These are the rule of results, the rule of relevance and the rule of robustness. To meet these basic rules, two subsidiary or auxiliary rules have been postulated viz. the rule of redundancy and the rule of resiliency. It is noteworthy that these rules are more relevant to substantive tax reform as opposed to tax administration reform.¹⁷ These rules are addressed in greater detail in Part 1.7.3 herein.

The main purposes of taxation are, first, to raise government revenue, second, distribution of wealth and, third, policy formulation and application where it is intended to have an impact on the public's consumption habits. Taxation is also used to promote or protect industries within the broader industrialisation plan of a country. Taxes become undesirable when they inhibit commerce and development. They are also not beneficial to the government if they do not raise the desired revenue. Though tax is an exaction, the tax authorities in modern day economies must also be interested in the views of the public in respect of a tax. Indeed, since there should not be taxation without representation, there ought not to be taxation without consultation. In modern economies, consultation and public participation can only be achieved through people's representatives as it is practically impossible to hold ancient Athenian public meetings to make resolutions on public matters. This is because of the sheer size of populations and geographical reach of countries.

¹⁵*Ibid*, pp. 193-201.

¹⁶ The term 'basic tax law' is used here to denote a legal regime that facilitates the achievement of the objective of a particular tax and within the larger context of development in a country.

¹⁷Bird, R. M. (1992) *supra*, pp. 183-185.

¹⁸ The purpose of raising government revenue appears to be the overriding principle in many modern economies. However, it is important to consider the other purposes as relevant, even if not dominant.

1.1.1 Kenya

Tax law in Kenya is statutory. There is no common law of taxation. ¹⁹ The main laws applicable to tax in Kenya are contained in the Constitution of Kenya, various Acts of Parliament and the various Finance Acts enacted annually. Article 210(1) of the Constitution of Kenya, 2010, requires that no tax or licensing fee may be imposed, waived or varied except as provided by legislation. The main tax statutes include the Income Tax Act, the Value Added Tax Act and the Customs and Excise Act. The statutes relevant to county taxes include the Entertainments Tax Act, the Valuation for Rating Act and the Rating Act (these need extensive amendments to effectively apply to Counties).

The Kenya government adopted the Tax Modernization Programme in 1986 and the Budget Rationalization Programme in 1987. The foundation for this was laid in Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth. This was first conceived in Sessional Paper No. 10 of 1965 on African Socialism and its Application to Planning in Kenya.²⁰ The modernization programme sought to enlarge the government revenue base whereas rationalization involved regulating expenditure through strict fiscal controls. Specifically, the Modernization Programme sought to:

- a. raise the tax revenue GDP ratio from 22% in 1986 to 24% by the mid 1990s.
- b. reduce compliance and administrative costs through low and rationalized tax rates and wider tax bases.
- c. improve tax administration by sealing leakage loopholes, making wider use of computers and enhancing audit surveillance, and
- d. enhance the institutional capacity to manage tax policy by establishing effective database management systems.

These objectives were later expanded to include raising the revenue-GDP ratio to 28%; invigorating the growth of the fledgling capital market; emphasizing self-

¹⁹ Mayson, S. W. & Blake, S. (1990) Mayson on Revenue Law (Eleventh Edition) Blackstone Press Limited, London, p. 4.

²⁰ Kenya, Government of (1965) Sessional Paper No. 10 of 1965 on African Socialism and its Application to Planning in Kenya, Nairobi.

assessment systems; strengthening taxpayer education and service; and, implementing organisational reforms that would modernise tax administration.²¹

Between 2003 and 2004, revenue collections rose by about 2 percentage points of GDP as a result of improvements in administration and governance. Since then revenue collection has remained around 21 percent of GDP, except for the financial year 2005/06 when the same was not attained due to problems associated with the computerisation of customs services which resulted in lower import duties and VAT on imports.²²

Revenues were targeted to rise from 20.7% of GDP in 2006/07 to 22% by 2015 and remain at that level to 2030. This is expected to be achieved despite the reduction in the scope for raising taxes from duties as a result of the COMESA and EAC trade liberalization, tax harmonization and the coming into force during this period of the Eastern and Southern Africa (ESA) – European Union (EU) - Economic Partnership Agreement (EPA). The resultant effect might be a heavier tax burden on taxpayers unless mechanisms to net in more taxpayers are adopted to widen the tax base. However, the Kenya Vision 2030 does not provide specific strategies to be used to maintain a strong revenue effort.²³

The Government established a Tax Harmonization Taskforce to review and propose appropriate recommendations on reforming the tax system to facilitate achievement of Vision 2030.²⁴

As will be seen later in Chapter 2, the tax gap is a major guide in the determination of the general reform strategy to be adopted. Prior to the various tax administration reforms carried out in Kenya, no comprehensive study and analysis of the country's

²¹Muriithi, M. K. and Moyi, E. D. (2003) *Tax Reforms and Revenue Mobilization in Kenya*, AERC Research Paper 131 African Economic Research Consortium, Nairobi, p. 3.

²² Kenya, Republic of (2007) *Kenya Vision 2030*, p. 3.

²³*Ibid* n 6

²⁴ Kenya (2009) Budget Speech for the Fiscal Year 2009/2010 (1st July – 30th June), p. 20.

tax gap has been carried out. It therefore follows that the general approach to reform has failed to adhere to the basic tenets.

The tax reform strategies have also shown signs of inconsistency. This is indicative of a haphazard methodology without a basic design. For instance, whereas the Tax Modernization Programme of 1986 sought to raise the tax revenue-GDP ratio from 22% in 1986 to 24% by the mid 1990s and subsequently to 28%, the target of *Kenya Vision 2030* is to raise the revenue-GDP ratio from 20.7% in 2006/07 to 22% by 2015 and retain that level until 2030.

Complying with tax requirements in Kenya takes longer compared to neighbouring countries. It takes 417 hours for a firm in Kenya to calculate and pay all required taxes, far longer than in Burundi, Uganda, Rwanda and Tanzania. The world average is 286 hours. This is due to the complications in the tax system.²⁵

Since independence, several tax administration reforms have been undertaken. The main ones include: -

i) The introduction of the Personal Identification Number (PIN) or Taxpayer Identification Number (TIN) for proper identification and tracking of taxpayers.

Kenya operates a PIN system. Every taxpayer of direct taxes must register and be assigned his individual PIN. This is necessary for filing of income tax returns and other tax returns. It has also become a requirement for various transactions involving government offices.

A robust system of taxpayer identification is key to good revenue administration.²⁶ This requires control measures such as those ensuring that

²⁶Kloeden, D. (2011) *Revenue Administration Reforms in Anglophone Africa since the Early 1990s*, IMF Working Paper WP/11/162, International Monetary Fund, Washington, p. 30.

²⁵PricewaterhouseCoopers and The World Bank (2009) "Paying Taxes 2010," as quoted in *Standard Business*, December 4, p. 27.

no PIN is assigned to more than one taxpayer and that each taxpayer is assigned only one PIN.²⁷

A comprehensive analysis of taxpayer identification and registration, and PIN is the subject of Chapter 3.

ii) The formation of the Kenya Revenue Authority as the centralised government agency for tax collection.

The Kenya Revenue Authority (KRA) was established in 1995. This was in tandem with other countries in sub-Saharan Africa that established their own semi-autonomous revenue agencies. These include Ghana (1985), Uganda (1991), Zambia (1994), Malawi (1995), Tanzania (1996), South Africa (1997), Rwanda (1998), Zimbabwe (2001), Ethiopia (2002), Sierra Leone (2002), Lesotho (2003), The Gambia (2005), Mauritius (2005), Mozambique (2006), Burundi (2010) and Swaziland (2011). The basis for the creation of KRA was laid in 1986 through the Tax Modernization Programme and Sessional Paper No. 1 of 1986 on "Economic Management for Renewed Growth".

The concept of autonomous revenue agencies and KRA are the subject of Chapter 4.

iii) The management of Income Tax and Value Added Tax (VAT) under the Domestic Taxes Department of KRA.

²⁷Silvani, C. and Baer, K. (1997) *supra*, pp. 17-18.

²⁸Fjeldstad, O-H and Moore, M. (2009) "Revenue authorities and public authority in sub-Saharan Africa," Journal of Modern African Studies, 47:1, p. 2; Manasan, R. G. (2003) "Tax Administration Reform: Semi-Autonomous Revenue Authority, Anyone?" Philippine Journal of Development, No. 56, p. 173; Kloeden, D. (2011) Revenue Administration Reforms in Anglophone Africa since the Early 1990s, p. 13; and, Fjeldstad, O-H & K. K. Heggstad (2011) The Tax Systems in Mozambique, Tanzania and Zambia; Capacity and Constraints, CMI, p. 28.

²⁹ KRA (2010) *supra*, p. 14.

This was done during the first Phase of the Revenue Administration Reform and Modernization Programme (RARMP). This was a step towards restructuring KRA from a tax based organisation to a functional form. A tax based authority has departments based on the various taxes whereas a function based authority operates under departments such as domestic taxes department, large taxpayers department and an enhanced support services department. Prior to the reorganisation, income tax and VAT were administered under different departments each headed by a Commissioner.³⁰

iv) The introduction of the 'Simba 2005 System' to enhance the collection of customs duty.

This is hailed as one of the achievements of the first phase of RARMP. It was implemented to facilitate self-assessment and the Post Clearance Audit (PCA) function was strengthened. It suffered some hiccups in its implementation such as failures of the computer system, reducing revenue collections.³¹ The "Simba 2005 System" was developed from the Senegalese customs system that operated a system known as GAINDE 2000.³²

The Simba 2005 System, among others, is the subject of consideration in Chapter 5.

v) The introduction of the Electronic Tax Register (ETR) to enhance collection of the Value Added Tax (VAT).

ETR was implemented through various public notices, mainly Public Notices No. 48, 49 and 50 of 15th December 2004. KRA is also in the process of implementing the Fiscal Electronics Signature Device (FESD).³³ The ETR was

³⁰ http://kra.go.ke/rarmp/rarmp/html.

³¹ http://kra.go.ke/rarmp.rarmp/html.

³² KRA (2010) *supra*, p. 61.

³³http://kra.go.ke/vat/esigndevice1204.html and http://kra.go.ke/noticesesdguide2000105.php.

introduced after study visits to Italy, Greece and Turkey.³⁴ ETR is studied in Chapter 5.

vi) The introduction of the Certificate of Tax Compliance and its requirement in dealings with government offices.

Upon full implementation, every person dealing with government offices will be required to produce a Certificate of Tax Compliance. This will ensure compliance. It, however, depends on co-operation from other government offices.

vii) The introduction of a Turnover Tax as an alternative to the payment of VAT.

This was done to promote compliance by removing taxpayers with a turnover below the threshold of Ksh. 5 million turnover per year from the VAT regime to the turnover tax regime and thus simplifying their mode of making returns.

viii) The introduction and implementation of the Integrated Tax Management System (ITMS) by KRA.

This is one of the key programmes in the KRA's Fourth Corporate Plan for 2009/10 to 2011/12. The theme of the Plan was "Attaining international best practice in revenue administration by investing in a professional team, deepening reforms and quality service delivery to enhance compliance". The intention is to ensure that all revenue departments are fully automated.³⁵ The ITMS is based on the Chilean tax system.³⁶

It must be ensured that the implementation of computer technology is in tandem with the appropriate changes in the tax administration's key procedures, including registration, collection, audit and enforcement.³⁷

³⁴ KRA (2010) *supra*, p. 85.

³⁵ http://kra.go.ke/publications/corporte-plan-final-combined.pdf.

³⁶KRA (2010) *supra*, p. 123.

³⁷Silvani, C. and Baer, K. (1997) *supra*, p. 20.

The ITMS is studied in greater detail in Chapter 5.

ix) Others include taxpayers' clinics and other taxpayer education services.

1.2 STATEMENT OF THE PROBLEM

The several tax administration reforms undertaken in Kenya do not exhibit a discernible strategy, theme, policy or methodology. There is no clear, deliberate and integrated reform mechanism to avoid haphazard implementation of reforms.

There has been inconsistency in the tax reform strategies to adopt. For instance, whereas the Kenya Vision 2030 proposes to raise the tax revenue-GDP ratio from 20.7% in 2006/07 to 22% by 2015 and maintain that level until 2030, the earlier Tax Modernization Programme of 1986 sought to raise the same from 22% in 1986 to 24% by mid 1990s and thereafter to 28%. This is indicative of a haphazard formulation of policies.

It is clear from the various initiatives that the government has involved itself more with the development and introduction of gadgets to deal with tax administration. These include Electronic Tax Registers (ETRs), the 'Simba 2005' System (S2005S), the Integrated Tax Management System (ITMS) and Personal Identification Numbers (PIN). Most of these systems are borrowed from other jurisdictions. The S2005S has its origins in Senegal, the ITMS was borrowed from Chile and the ETR was implemented as a result of study visits to Italy, Greece and Turkey. Without a proper basic tax law, such a route becomes a false lead to achieving the desirable results.

The S2005S encountered serious teething problems at its implementation arising from both internal and external resistance. There has been opposition to the ETR especially on whether it is fair to shift the burden of tax accounting to the tax payer and whether professionals should be subjected to it. The debate as to the extent of application of the Personal Identification Number (PIN) in accessing public services

is still alive. The effect of the foregoing is that there is revenue loss or the cost of collecting revenue increases.

With the above background, implementation of county tax administration is bound to be haphazard, and without measurable expectations. The problems at the national tax administration will inevitably be devolved to the counties.

This problem is magnified by the fact that county governments are inevitably taking over the systems and processes hitherto used by the defunct local authorities, which in most instances were dysfunctional. For instance, only four local authorities (Nairobi, Mombasa, Kisumu and Nakuru municipalities) had fully fledged property rates administration systems (not necessarily efficient, too).

Several issues arise. Will the counties use the KRA PIN for tax administration? If so, what about data security? If not, what is the effect of multiplicity of taxpayer registration? Will there be information-sharing between the counties and KRA? Who is the ideal tax administrator for county taxes: KRA or autonomous agencies within the counties or even the county civil service? Will the counties get access to the KRA electronic system?

This study looks at the problem where tax administration reforms have been effected without a discernible strategy and guidelines and without a composite objective in sight. It is therefore an analysis of the efficacy of the various reform initiatives with a view to identifying lessons to model a strategy to guide future reforms, moreso the implementation of county tax administration systems.

1.3 JUSTIFICATION/SIGNIFICANCE OF THE STUDY

This study is based on the need to seek solutions for the problem stated above. Here below is the justification for undertaking the research.

Article 175(b) of the Constitution of Kenya, 2010, requires that county governments should have reliable sources of revenue to enable them to govern and deliver

services effectively. This study is an attempt at partial satisfaction of this requirement.

Efficient and effective tax administration is central to a successful tax system in any country. Accordingly, it is necessary to have proper administration reforms if the set goals of taxation are to be achieved. The tax gap in Kenya is still in the range of 20 to 40 per cent and therefore in need of reform. Tax administration is the key prong in the performance of property taxes, which are the main source of revenue for subnational entities. The performance of property taxes in Kenya is below par and there is therefore need to make an attempt at improving administration.³⁸

Kenya has undertaken some tax administration reforms since independence. Some have worked. Others have not. Some have been fiercely opposed by stakeholders. There are some that have led to the loss of revenue. This has left a somewhat murky field or track record. A study of the process is therefore necessary at this time and in the prevailing circumstances.

Since tax administration is central to taxation, it is important to study whether its reform follows an identifiable and measurable process. It is also necessary to study whether the reforms comply with the basic rules of reform. The reforms should also be in accordance with the law. This will eventually translate into achievement of tax goals.

The purpose of any tax administration reform effort is to come up with an effective and efficient mode of management and collection of taxes. Reform efforts in taxation transcend the legal, economic and public finance aspects. There is therefore need to make an attempt at harmonising the different fields with a view to formulating implementable strategies for the administration that are more efficient and effective thereby leading to higher revenues.

Reform shortfalls in any tax jurisdiction usually trigger the need for a strategy and timescales. The Constitution of Kenya, 2010, necessitates the need for a strategy

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³⁸ Kelly, R. (2000) "Designing a Property Tax Reform Strategy for Sub-Saharan Africa: An Analytical Framework Applied to Kenya," *Public Budgeting & Finance*, Winter, 36-51, p. 38.

that would address both the national scope of reform vis-à-vis the subnational tax administration units.

It is important, with the wisdom of hindsight, to identify any discernible rules of tax administration reform in Kenya and use the same and other studies to formulate a sustainable administration for county taxes. This is important at a time like this when the legislation to actualize devolution in terms of the Constitution of Kenya, 2010, has not been formulated.

The significance of this study, therefore, is that it is a contribution to existing knowledge on tax administration reforms. It creates a database in addition to analyzing available information. More importantly, it comes up with methodologies on the tax administration reforms for counties in Kenya. It is intended that the strategy formulated in this thesis would be useful for subnational tax administration reforms in any jurisdiction, with the necessary adaptations. Of immediate significance is that it will identify lessons upon which to model a strategy to actualize county tax administration towards full implementation of the Constitution of Kenya, 2010.

1.4 RESEARCH DESIGN

The research design adopted in this study is geared towards solving the problem as stated herein. It is intended to assist towards achieving the main goal of identifying lessons to model a strategy for the sustainable administration of county taxes in Kenya.

1.4.1. Research Objectives

The general objective of this research is the identification of lessons necessary to model a suitable and sustainable strategy for county tax administration reforms in Kenya and eventually, propose law reform measures towards modelling a strategy for sustainable administration of county taxes in Kenya.

The research has the following specific objectives: -

- To analyse and study the concept of taxpayer identification and registration, and the system of taxpayer identification and registration in Kenya with a view to assessing its efficacy and whether it is suitable for the administration of county taxes.
- To analyse and study the concept of Autonomous Revenue Authorities (ARAs), the establishment of the Kenya Revenue Authority (KRA), whether it has achieved its object and whether it can sustainably be devolved to the counties for the administration of county taxes.
- To investigate whether the electronic and automation systems introduced in Kenya in the reform of tax administration have achieved their objectives and whether they, or their equivalents, would be suitable for the administration of county taxes.
- 4. To investigate whether the tax administration reform process has brought about any discernible rules or guidelines and whether these can form benchmarks to guide future tax administration reforms.
- 5. To identify the basic rules to be used in the modelling of a strategy for the sustainable administration for county taxes in Kenya and propose requisite law reform measures.

The research questions this study sought to answer are the following:

- 1. Is the Personal Identification Number (PIN) used at the national level by the Kenya Revenue Authority (KRA) suitable for the administration of county taxes in Kenya?
- 2. Is the concept of Autonomous Revenue Authorities (ARAs) suitable for the administration of county taxes in Kenya?
- 3. Are the electronic and automated systems in use by the Kenya Revenue Authority (KRA) suitable for the administration of county taxes in Kenya?

4. What lessons can we draw from past tax administration reforms in Kenya to aid in developing models for administration of county taxes?

1.4.2 Research Methodology

This study was undertaken in both primary and secondary approaches.

For the primary research, interviews were conducted with officials of the Kenya Revenue Authority (KRA), taxpayers, both corporate and individual, and tax professionals. Interviews were by way of open-ended question questionnaires. The questions sought both factual data and opinions of the respondents. These included key informant interviews. This is justified by the fact that the research area is highly technical and useful data is likely to be received only from persons knowledgeable in the subject matter.

The rationale for seeking data from the three primary sources is the seeking of opinions from varied perspectives of persons involved in the tax cycle at different stages. Whereas KRA officers would give information from a policy standpoint, taxpayers and tax professionals give their experiences on how KRA attempts to implement policy. This justified the decision to have the three categories of respondents.

1.4.2.1 KRA Officers

Twelve (12) officers from the KRA returned their questionnaires after a random distribution of 42 questionnaires in the departments in respect of which authority to interview had been granted. The researcher distributed more questionnaires than previously intended in the respective departments as a move towards getting more views within the limited authorised departments. Further, by way of triangulation, the research also relied on reports and other published works from KRA.

Upon seeking authority to interview officers working at the KRA, limited authority was granted. Accordingly, the researcher only had access to officers working in the Large

Taxpayers Office (LTO), the Legal Department and the Policy, Compliance Risk Management and Research Division. The interviewees hold the ranks of Officer, Senior Officer, Assistant Commissioner, Senior Assistant Commissioner and Deputy Commissioner. It was optional for the interviewees to indicate their names. All of them chose not to indicate it. The information received was also checked against the available KRA reports. The questionnaire required the interviewees to identify the various tax administration reforms initiatives undertaken by KRA; the impact and effectiveness of those initiatives; the existence or otherwise of rules or guidelines to guide future tax administration reforms; the reform measures taken or proposed by KRA to guide tax administration in the counties; and, proposals modelling a sustainable county tax administration system. The questionnaire is attached hereto as Appendix 1.

An oral interview was also conducted with a Manager in the Policy, Compliance Risk Management & Research Division of KRA³⁹ to supplement the questionnaires. This was important to the study as it gave insights on the policy direction taken by KRA.

1.4.2.2 Taxpayers

The sampling for administering the taxpayers' questionnaire was conducted by identifying key informants by having them answer a preliminary question that they pay taxes and have a general understanding on the tax system. This was necessary because the subject matter is highly technical and the questionnaire required opinions to be given. As such, opinions can only be given by those who possess some understanding and knowledge on the research area. These informants were also requested to propose other possible interviewees. Seventy (70) questionnaires were administered. Twenty two were returned. However, four (4) were rejected as they were incomplete in material respects and could not be analysed. Accordingly, eighteen (18) questionnaires were analyzed. Out of these, four (4) were from corporate taxpayers, twelve (12) from individual taxpayers, one (1) indicated that he filled in the questionnaire in both capacities and one (1) did not indicate. The name was optional, and only two (2) provided their names. The questionnaire required the

³⁹ Interview conducted with Mr. Juma on 29th July 2013 at KRA offices, Times Tower, Nairobi. 'Mr. Juma' is a pseudonym used for the said officer as he chose to remain anonymous and he was assured of confidentiality.

interviewees to indicate the use and efficiency of the various tax administration reform initiatives by KRA; the challenges; and, proposals on efficient tax collection. The questionnaire is attached hereto as Appendix 2.

1.4.2.3 Tax Professionals

For purposes of interviewing tax professionals, the researcher used the 'big four accounting firms'⁴⁰ in Kenya. This was justified in that the four have specialized tax departments. Four (4) questionnaires were dispatched to the tax departments of each of the four making a total of sixteen (16) questionnaires. No returns were received from one (1) of the firms. The other three firms returned one (1), two (2) and two (2) questionnaires, respectively. The questionnaire required the interviewees to assess the impact and efficiency of various tax administration reform initiatives and to propose ways of modelling an effective system for county tax administration. The questionnaire is attached hereto as Appendix 3.

In total, thirty five (35) questionnaires were analyzed.

1.4.2.4 Focus Group Discussion

Informed by the special nature of the research, the researcher used a Focus Group Discussion (FGD). The purpose was to get insights into different opinions on the formulation of a strategy for the administration of county taxes, tested through discussions and input from various perspectives. This group consisted of six (6) lawyers who have practised law for between two (2) and fifteen (15) years. Of the six (6), one (1) works for KRA. This complemented the data collected through questionnaires and interviews.

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⁴⁰ This phrase is globally used to refer to Deloitte, Ernst & Young, KPMG and PWC. The four rank highly in terms of performance and revenues, far beyond other accounting firms.

1.4.2.5 Secondary Research

Secondary research involved both worldwide web and library research. Key materials reviewed are the various relevant Acts of the Kenyan Parliament and reports of the Kenya Revenue Authority (KRA). The quantitative data from the KRA reports was found to be useful in analysing revenues, and by way of triangulation, as a cross-check on the clarity and data received from KRA officers through interviews.

1.4.2.6 Conclusion

The data received required both qualitative and quantitative analysis. Whereas qualitative data was the cornerstone of the research, quantitative data was used to put into perspective the full picture. Quantitative data analysis was especially useful in measuring the popularity of various reform initiatives. On its part, qualitative data analysis aided in providing the substantive basis of reform efforts and results.

The research exercise encountered difficulties on the part of administration of questionnaires. Whereas potential interviewees readily accepted to take part in the exercise, it required a lot of effort and reminders to get back the filled out questionnaires. Indeed only 30.5% of the questionnaires distributed were received.

The foregoing notwithstanding the research exercise yielded the intended results. It provided useful information on, among others, the concept of ARAs, the identification and registration of taxpayers, the use of electronic and automated systems and the concept of tax reform.

The flow of the research is represented by the figure below.

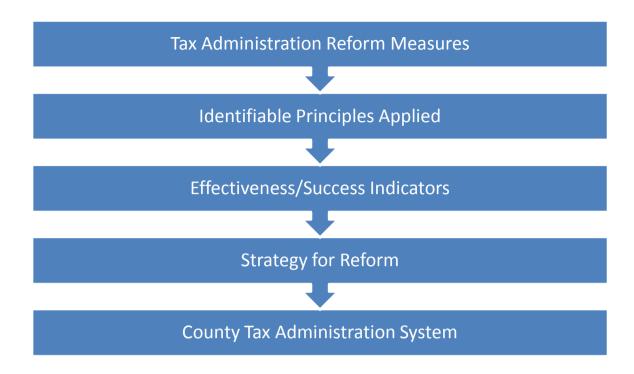


Figure 1. Research flow chart

The figure above shows that this research commences at the point whereby certain tax administration reform measures have been undertaken at the national level (for example, establishment of an ARA). From those measures, attempts are made to discern any principles that were applied (for example, consolidation of services). Flowing from the reform measures and the principles applied, we test the effectiveness and identify any success indicators (for example, tax/GDP ratio). Those success indicators can then be used in the formulation of a reform strategy that will eventually give us the county tax administration.

1.4.3 Hypotheses

This research proceeded on the hypotheses laid out hereunder.

First, the Personal Identification Number (PIN) used at the national level by the Kenya Revenue Authority (KRA) is not suitable for the administration of county taxes

in Kenya. As will be seen in Chapter 3, this hypothesis was discredited by the research findings.

Second, the concept of Autonomous Revenue Authorities (ARAs) is not suitable for the administration of county taxes in Kenya. The research findings supported this hypothesis as will be seen in Chapter 4.

Third, the electronic and automated systems in use by the Kenya Revenue Authority (KRA) are not suitable for the administration of county taxes in Kenya. As will be seen in Chapter 5, whereas the research findings supported the use of electronic and automated systems, specific systems are needed for county tax administration.

1.5 <u>LITERATURE REVIEW</u>

The goal of undertaking a literature review was to evaluate the available knowledge on tax administration reforms with a view to informing this study and situate the study within the body of literature. This was important so as to enable the researcher conceptualize and contextualize the various issues. The researcher collected books, articles and reports that were relevant to the subject, some in hard copies and others from internet sources. The main themes of the study were identified and literature relevant to them sought.

1.5.1 Autonomous Revenue Agencies

Hadler notes that in the recent past, the trend in many developing countries has been to set up (semi-) autonomous revenue agencies (ARAs) to replace the offices or departments charged with collection of taxes.⁴¹ This has been done as a perceived means to sustained revenue improvement.⁴² Manasan argues that such

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⁴¹Hadler, S. C. (2000) *Improving Tax Administration in Sub-Saharan Africa: The Potential of Revenue Agencies and Electronic Service Delivery*, United Nations, p. 3; Manasan, R. G. (2003) *supra*, p. 173; and Fjeldstad, Q-H and Moore, M. (2009) *supra*, p. 1.

⁴²Hadler, S. C. (2000) *supra*, p. 3.

radical reform of the tax agencies was primarily intended to improve revenue performance due to the deep-seated problems in tax administration.⁴³

As noted by Fjeldstad and Moore, Manasan, and Kloeden, in Sub-Saharan Africa, the following countries have established semi-autonomous revenue authorities (with years of establishment): Ghana (1985), Uganda (1991), Zambia (1994), Kenya (1995), Malawi (1995), Tanzania (1996), South Africa (1997), Rwanda (1998), Zimbabwe (2001), Ethiopia (2002), Sierra Leone (2002), Lesotho (2003), The Gambia (2005); Mauritius (2005); Mozambique (2006); Burundi (2010) and Swaziland (2011).

Fjeldstad and Moore, Hadler and Kloeden have assessed the role played by external institutions in the adoption of this model in Africa. As will be seen in Chapter 4, external forces have continued to offer advice and technical assistance to the new tax administrations.⁴⁵

It is interesting to note that Manasan and Hadler hold the view that though autonomous revenue agencies were perceived as a means to sustained revenue improvement, there is little sign that their creation has actually increased public revenues. 46 Kloeden seems to support this view and adds that indeed, between 1996 and 2007/08, the tax/GDP ratio for Kenya dropped by -2.3. It also dropped in Seychelles, Zambia and Zimbabwe over a similar period. 47 However, Fjeldstad and Moore, and Hadler also see a positive impact in that it has facilitated a range of reforms in the ways in which taxes are assessed and collected. 48 Kloeden notes that,

⁴³Manasan, R. G. (2003) *supra*, p. 173.

 ⁴⁴Fjeldstad, O-H. and Moore, M. (2009) *supra*, p. 2; Manasan (2003) *supra*, p. 173; Kloeden (2011) *supra*, p. 13; and Fjeldstad, O-H & K. K. Heggstad (2011) *The Tax Systems in Mozambique, Tanzania and Zambia; Capacity and Constraints*, p. 28. Whereas this had largely been highlighted at pp. 8-9 herein, it was deemed appropriate to restate them to ensure a smooth flow of the literature being reviewed here.

⁴⁵Fjeldstad, O-H. and Moore, M. (2009) *supra*, p. 3; Hadler, S. C. (2000) *supra*, p. 4; and, Kloeden, D. (2011) *supra*, p. 4..

⁴⁶Manasan, R. G. (2003) *supra*, p. 173; and Hadler, S. C. (2000) *supra*, p. 3.

⁴⁷Kloeden, D. (2011) *supra*, p. 7.

⁴⁸Fjeldstad, O-H. and Moore, M. (2009) *supra*, p. 1; and Hadler, S. C. (2000) *supra*, p. 3.

on average revenue collection increases across 40 sub-Saharan African countries between 1980 and 2005 are mostly, if not entirely, attributed to resources revenues, with collections in countries without resources mostly stagnant.⁴⁹ The Kenya Revenue Authority offers that in Kenya, revenues have increased since the establishment of KRA. Revenue growth averaged over 11 per cent between 1995/96 and 2008/09.⁵⁰

Hadler notes that in Kenya and South Africa, the objective of establishing autonomous agencies was to improve effectiveness, efficiency and equity of the tax administration. This contrasted with the objective in other countries such as Ghana, Uganda, Zambia and Tanzania, which was mainly to increase tax revenues.⁵¹ As far as this objective is concerned it is arguable whether the establishment of KRA achieved its object.

Manasan interestingly notes that, whereas in countries such as Malaysia and Zambia the creation of semi-autonomous revenue authorities appears to have no tangible impact on tax effort, contrastingly, in Kenya, tax effort declined despite the creation of a semi-autonomous revenue authority.⁵² Tax effort is an index measure of how well a country is doing in terms of tax collection relative to what could be reasonably expected given its economic potential and is calculated by dividing its actual tax share by an estimate of how much tax the country should be able to collect given the structural characteristics of its economy.⁵³

Hadler suggests that the need to increase revenues has been the prime reason for establishment of new revenue agencies in most instances in sub-Saharan Africa. She also identifies other special reasons for the establishment of the agencies in some countries. For instance, in Tanzania and Uganda, the disarray of revenue collection and pervasive corruption were the motivating factors, while in Kenya and

⁴⁹Kloeden, D. (2011) *supra*, p. 7.

⁵⁰KRA (2010) *supra*, p. xv.

⁵¹Hadler, S. C. (2000) *supra*, pp. 3-4.

⁵²Manasan, R. G. (2003) *supra*, p. 181.

⁵³ African Development Bank (ADB)(2010) *Domestic Resource Mobilization across Africa: Trends, Challenges and Policy Options*, Committee of Ten Policy Brief No. 2/2010, p. 3.

South Africa, the objective was less to increase tax revenues than to improve effectiveness, efficiency and equity of the tax administration.⁵⁴

According to Manasan, the rationale for establishing semi-autonomous revenue agencies has been the need for radical changes in tax administration in countries where the tax gap is large. Tax administration in these countries was characterized by a rigid civil service, widespread perception of corruption and consequently, low voluntary compliance because of the perceived lack of fairness in the enforcement of tax laws. ⁵⁵

Manasan goes on to hold that revenue agencies are also given autonomy in an endeavour to make a credible commitment to taxpayers that the tax collection agency will be more competent, efficient and fair. By turning tax administration over to an independent agency, the reform aim would be to depoliticize tax collection and minimise the risks that politicians will undo the reform at a later date.⁵⁶

Hadler justifies the establishment of autonomous agencies on the basis of the following apparent benefits: perceived increased effectiveness, efficiency and equity of a new agency by taxpayers, resulting in an increase in compliance and tax revenues; greater flexibility in human resource management free from the constraints of public service regulations; to restructure and integrate tax operations so as to take advantage of economies of scale and information, and to eliminate duplication of functions; and independence to take legal action directly against taxpayers.⁵⁷

Hadler, however, notes that there are disadvantages of the revenue agency approach which include: improved revenues could be realized without the costs of establishing a new agency; the establishment of a new agency may be promoted by those who stand to benefit; and autonomous agencies have proven more costly than

⁵⁴Hadler, S. C. (2000) *supra*, p. 4.

⁵⁵Manasan, R. G. (2003) *supra*, p. 174.

⁵⁶ *ibid*, p. 175.

⁵⁷Hadler, S. C. (2000) *supra*, pp. 4-5.

the tax agencies they replace. In some cases, the collection costs to tax revenue ratio have increased. Others include the view that the establishment of autonomous agencies is not an alternative to civil service reform, and may contribute to fragmentation of the civil service and to problems of inter-agency co-operation; a clear regulatory and supervisory framework is needed to ensure that autonomy is not abused; autonomy does not guarantee an end to political interference; and, legal and political factors may continue to constrain human resource policies.⁵⁸

Fjeldstad and Moore observe that though ARAs differ from one another in many respects, they share significant features. The agency is granted, in law, some autonomy from central executive power, partly with the purpose of limiting direct political interference in its day to day operations. It is also meant, in principle, to be quite independent of the financing and personnel rules that govern the public sector in general. Lastly, all central government tax operations are integrated into one single-purpose agency.⁵⁹

Manasan identifies the key design features that define semi-autonomous revenue agencies. They are all created by law, which also defines their legal character. They follow any one of two governance models: the Chief Executive Officer (CEO) model or the Board of Directors (BOD) model. The semi-autonomous revenue agencies also receive budgets which are set as fixed or variable percentages of that actual collection. They have a defined personnel system and accountability mechanisms whereby there is a code of ethics for all employees.⁶⁰

Fjeldstad and Moore are of the opinion that though ARAs were created to increase government revenues, they have contributed little to that goal.⁶¹ Indeed, establishing ARAs has the potential to create new problems as well as to solve old ones. Their creation poses a threat to the synchronization of tax collection and tax policy.⁶²

⁵⁸*Ibid*, pp. 6-8.

⁵⁹Fjeldstad, O-H. and Moore, M. (2009) *supra*, p. 3.

⁶⁰Manasan, R. G. (2003) *supra*, pp. 176 - 180

⁶¹Fjeldstad, O-H. and Moore, M. (2009) supra, p. 14.

⁶²*Ibid*, p. 13.

Manasan seems to be of the same view when he says that they have been less sustainable than expected. Even in many countries that have shown some degree of success with the semi-autonomous revenue agency model, there is some evidence that the gains in revenue performance tends to be eroded after some time. He continues to argue that the main challenge to the autonomy of the RA has been the government itself in as much as the very design of semi-autonomous RAs gives rise to "dynamic of conflict and competition between the government and the RA". He notes that the more successful ones appear to have a higher degree of autonomy. He had been the government and the real successful ones appear to have a higher degree of autonomy.

Hadler observes that revenue agencies are not a universal solution for tax administrations and they cannot be guaranteed insulation from political interference. Further, the establishment of a new agency is not always necessary, and care needs to be given to the establishment costs in relation to revenue gains.⁶⁶

KRA identifies itself as a successful public sector organization. This is because since its inception in 1995, it has often exceeded revenue targets. Revenue growth for the period between 1995/96 and 2008/09 averaged over 11 per cent.⁶⁷

According to Eissa and Jack, tax collection responsibilities at the KRA are divided into two main departments; the Domestic Taxes Department (DTD) and the Customs and Excise Department (CED). The DTD covers personal and corporate income taxes, withholding tax, VAT on domestically produced goods, domestic excises and some other smaller taxes. CED is responsible for all excise tax collection (on both domestically-produced goods and imports), all trade taxes and VAT collected on imports.⁶⁸

⁶³Manasan, R. G. (2003) *supra*, p. 183.

⁶⁴*Ibid*, p. 184.

⁶⁵*Ibid*, p. 185.

⁶⁶Hadler, S. C. (2000) *supra*, p. 11.

⁶⁷KRA (2010) *supra*, p. xv.

⁶⁸Eissa, N. O. and Jack, W. (2009) *Tax Reform in Kenya: Policy and Administrative Issues*, Initiative for Policy Dialogue Working Paper Series, pp. 21-22.

Eissa and Jack also note that KRA created a Large Taxpayer Office (LTO) to specifically monitor and provide services to taxpayers that contribute the bulk of revenues. The eligibility criterion to be subject to LTO control is an annual turnover of Ksh.1 billion, and firms in certain lines of business like financial institutions, regardless of turnover. Government agencies are also included. One problem that arises is that revenue from these companies is no longer collected through the relevant branch office or station, which meets some resistance from the said stations.⁶⁹

According to KRA, the LTO targeted income taxpayers with an annual turnover exceeding Ksh. 500 Million, all banks and insurance companies and loss making companies with turnover in excess of Ksh. 250 Million. It also targets the top 200 VAT taxpayers over a two-year period and excise duty taxpayers paying amounts exceeding Ksh. 1.2 Million.⁷⁰

The position by Eissa and Jack on the targeted taxpayers contradicts that of KRA, which is the official position.

As noted earlier, the revenue authorities of Kenya and South Africa were established around the same time and for the same reason. They therefore give a fair comparison.

Tax reform in post-apartheid South Africa can be examined in two broad phases. These are the Katz Commission's⁷¹ policy review and its implementation period from 1994 to 1999 and the post-2000 tax reform phase characterized by a rapid improvement of administrative capacity in the South African Revenue Service and

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⁶⁹*Ibid*, pp. 22-23.

⁷⁰KRA (2010)*supra*, p. 33.

The Commission was appointed on 22nd June 1994 as the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa. It became known as the Katz Commission, after its chairman Michael Katz. It was to investigate virtually every aspect of the South African tax regime against the backdrop of the political, social and economic goals of the new government.

the implementation of two massive structural adjustments to the country's income tax system. 72

The first steps in the reform of the tax administration in South Africa took place on 18th October 1995 when the cabinet approved the restructuring of the Inland Revenue and Customs and Excise Directorates in the Department of Finance into the South African Revenue Service (SARS). SARS has introduced specific measures to improve efficiency of tax collection thereby reducing the tax gap.⁷³ One of the shortcomings of the Katz Commission reports is its relative lack of quantitative underpinnings.⁷⁴

The South African tax collections in the fiscal year 1999 exceeded 27 percent of GDP. The government pledged to reduce it to 25 percent.⁷⁵

SARS has been the most consistent success story among autonomous revenue agencies in sub-Saharan Africa. Its staff provides consultancy and advisory services to other countries in the region.⁷⁶ However, the autonomy has not freed SARS from political interference. For instance, the Chief Executive of SARS has, since soon after its establishment in 1997, been a very senior member of the ruling African National Congress (ANC).⁷⁷ As will be seen in Chapter 3, the Chief Executive of KRA is appointed by the Cabinet Secretary in charge of the Treasury. He is a public servant and therefore not supposed to be a politician.

The literature provides compelling reasons for the need of ARAs in the administration of taxes. Demerits are also identified. It does not necessarily follow that the autonomy of the tax administration agency will lead to the achievement of

⁷² Manuel, T. A. (2002) "The South African Tax Reform Experience since 1994," Address by the Minister of Finance to the Annual Conference of The International Bar Association, October 24, p. 1.

⁷³*Ibid*, p. 3.

⁷⁴ Aaron, H. J. (2009) "The South African Tax System: A Nation in Microcosm", Brookings Institute, (available at http://www.brookings.edu/articles/1999/1206africa-aaron.aspx? accessed on 19th November 2009), p. 1.

⁷⁵*Ibid*, p. 2.

⁷⁶Fjeldstad, O-H. and Moore, M. (2009) *supra*, p. 11.

⁷⁷*Ibid*, p. 6.

the desired objects as other factors are also relevant. The design and structure of the ARAs is discussed, and what it means to efficiency.

The literature has not endeavoured to delve into the issue of whether the success, if any, of the Kenya Revenue Authority (KRA) has been due to the autonomous character or that revenues were bound to rise anyway due to the improvement in the socio-economic and political aspects. It is also not clear from the literature how the autonomy concept would be applied at the county level, and whether it is even necessary.

1.5.2 Electronic Service Delivery

Electronic service delivery involves the use of information and communication technologies in tax administration. It may refer to the use of computers or other electronic means.

Hadler holds the view that revenue agencies in sub-Saharan Africa need urgently to begin a process of reviewing their tax and customs laws and administration to ascertain their adequacy in the face of electronic commerce and to remedy as required. She defines electronic commerce as the delivery of information, products, services or payments by telephone, computer or other automated media.⁷⁸

According to Hadler, the impact of electronic commerce is such that it has been extremely effective in strengthening businesses and strengthening growth in new areas. It translates into costs saved in Business-to-Business (B2B) e-commerce and higher GDP growth. Electronic service delivery (ESD) also offers governments new opportunities and ways of doing business. Sub-Saharan African governments and their tax administrations cannot afford to further delay addressing electronic commerce.⁷⁹

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⁷⁸Hadler, S. C. (2000) *supra*, p. 12.

⁷⁹*Ibid*, pp. 12-13.

Silvani and Baer posit that computerization is an essential element for modernizing tax administration. The tax administration must keep up with the pace of computerization in major economic sectors, including banking, trade and communications. Unfortunately, the pace of computerization in tax administration in many countries has been slow. This is notwithstanding the advantages that would obtain, including increased capacity to process return and payment forms, compile statistics and improve revenue forecasting. They, however, continue to explain that the development of the tax administration's computer technology should be carried out in tandem with appropriate changes in the tax administration's key procedures, including registration, collection, audit and enforcement. Without this, there is the risk that computerization will not result in greater effectiveness in the tax administration's operations because inadequate procedures may have been computerized. ⁸⁰

Further, Silvani and Baer observe that the organization of the tax administration and the degree of centralization or decentralization of operations will determine the kind of computer systems which will be required and the appropriate location of the computer systems that compile and store detailed information on taxpayers' accounts. A more efficient approach is to decentralize functions such that the entry and storage of detailed data on taxpayers' accounts is done at the local tax office, which is nearest to the taxpayer, and only summary data for purposes of reporting and management is transmitted to the regional and central tax offices. Excessive centralization of systems usually results in rigidities, lack of user participation, delays in detecting and correcting input errors, and a reduction in the usefulness of computer systems. Extremely decentralized systems are also difficult to administer because training of staff and maintenance of hardware and software become costly and demand great efforts.⁸¹

According to Silvani and Baer, it is extremely important for the tax administration to maintain a degree of autonomy in designing its own computer systems.⁸²

⁸⁰Silvani, C. and Baer, K. (1997) *supra*, pp. 19-20.

⁸¹ Ibid.

⁸²*Ibid*, p. 21.

Hadler observes that electronic service delivery can provide enormous gains in effectiveness and efficiency for all branches of tax administration. It can help simplify and streamline operations, create more cost-effective administrations, improve compliance and timeliness and provide improved and convenient services. Its potential is greatest in customs, where technological change is at the heart of business process re-engineering. Globalization has contributed to increased activity for tax administrations worldwide and ESD offers the means to deliver expanded and improved services at constant or declining real cost. ESD can be an extremely important means to supporting the basic strategic objectives of a tax administration, namely simplification, efficiency, equity and accessibility.⁸³

The objective of ESD in tax administrations is enabling taxpayers to choose from a variety of secure, automated, self service channels to meet their tax and custom obligations, with services packaged to meet the needs of different client groups.⁸⁴

Hadler further notes that electronic commerce raises major new issues and challenges to established tax systems and laws. The potential with electronic commerce for avoidance and evasion is major and necessitates that countries review their tax policies and administration to ensure that tax laws are applied appropriately. There are challenges in determining where the commercial activity occurs and hence the jurisdiction with the authority to levy tax.⁸⁵

Hadler makes recommendations relating to the tax and regulatory environment. These include, the creation by government of a favourable policy and legal environment ensuring a tax neutral position with regard to electronic commerce transactions and building trust in the electronic market place. She also observes that the experience of various developed countries and international organisations, such as the OECD as well as the EU, provides a useful base for the developing countries.

⁸³Hadler, S. C. (2000) *supra*, pp. 13-15.

⁸⁴*Ibid*, p. 15.

⁸⁵*Ibid*, p. 16.

It is recommended that they should establish an Advisory committee and prepare an ESD strategy as a first step.⁸⁶

According to her ESD also introduces some inherent risks for clients, government and officials. The risks for taxpayers include privacy, security, cost, equity and burden of change. The risk for the government are risks to program delivery and continuity, increased costs from infrastructure overhead training and updating for technological change, and fraud and misuse. The risks for the officials include a changing work environment, changes in volumes of work and changes in skill needs. However, there are also potential risks in failing to innovate.⁸⁷

ESD offers considerable potential to tax authorities to reduce costs, improve efficiency, accessibility, transparency and client orientation, while simultaneously being an effective training and public relations tool.⁸⁸

KRA confirms that automation of tax systems in Kenya is almost always copied from other jurisdictions.⁸⁹ As will be seen later, this has its consequences especially where the system is not well adapted to local circumstances.

Whereas the literature is firm on the need to incorporate electronic means at the centre of tax administration, it does not take into consideration the important aspect of human behaviour. Machines are operated by human beings. Their efficiency and effectiveness largely depend on the personnel used. Instances of sabotage and resistance to change cannot therefore be ignored in the automation of a tax system.

1.5.3 Tax Administration Reform

As a result of the reform that has taken place over several decades, Kenya has the trappings of a modern tax system. For instance, it has a credit-invoice VAT, a PAYE

⁸⁶Hadler S. C. (2000) *supra*, pp. 16-17.

⁸⁷Ibid.

⁸⁸*Ibid*, p. 19.

⁸⁹ KRA (2010) *supra*, generally.

individual income tax with graduated but arguably moderate rates and a set of excise taxes focused on certain products such as alcohol, cigarettes and gasoline. However, with up to 70 per cent of GDP produced in the informal sector, which also employs close to 75 per cent of the labour, the ability of the tax system to raise sufficient revenue with minimal distortions is severely circumscribed. Continued reform of both the policy instruments and the administrative and enforcement capacity of the tax system is therefore imperative. This therefore clearly means that modernity in the system does not necessarily translate into efficiency and optimal performance.⁹⁰

According to Silvani and Baer, tax administration reform in developing countries is part of a broader fiscal reform effort aimed at restoring macroeconomic stability and at restructuring tax systems so that taxes are more efficient, less distortionary of market forces and easier to administer. Tax administrators in both developing and developed countries additionally face the challenge of modernizing the tax administration so that it can operate effectively in an increasingly global economy characterized by the growth of difficult-to-tax sectors such as the financial and other services sectors and by the rapid expansion of sophisticated computer and communications technology which could be used by taxpayers to conceal economic transactions. They also note that a country's particular circumstances should be taken into account in designing a specific strategy for the country. This research is substantially geared towards designing a specific strategy for Kenya.

In order to determine an appropriate tax administration reform strategy, Silvani and Baer suggest that countries should be categorised into four according to the tax administration's effectiveness i.e. the level of taxpayers' non-compliance. Effectiveness is frequently measured by the tax gap, which is the difference between the tax that should be paid according to the tax laws and regulations and the tax which is actually collected. ⁹²

⁹⁰Eissa, N. O. and Jack, W. (2009) *supra*, generally.

⁹¹Silvani, C. and Baer, K. (1997) *supra*, p. 4.

⁹² Ibid.

The general rule is that countries with a larger tax gap need to consider more fundamental changes in tax administration and the countries with a smaller tax gap need to keep up with the changes in the tax system and the taxpayer population in order to maintain high compliance levels and lower the costs of collection and compliance.⁹³

Silvani and Baer hold that in initiating tax reform, one of the first steps is to diagnose the existing problems and to develop an appropriate strategy. Indeed, they argue that the diagnosis is in itself an important exercise. To design a strategy, it is important to determine the tax administration's overall effectiveness usually measured by the country's tax gap. Other factors remaining constant, the larger the tax gap, the more radical the changes that need to be considered in the strategy.⁹⁴

They categorise countries into four on the basis of the tax gap. In the tax administrations that are very effective, the tax gap is very low and in the range of 10 percent or lower. In those which are relatively effective, the tax gap is between 10 and 20 percent whereas in those with relatively ineffective tax administrations, the tax gap is in the range of 20 to 40 percent. The fourth group consists of countries with a highly ineffective tax administration and a tax gap in the range of 40 percent or more. The use of this categorization in determining the nature of reform needed is addressed in Chapter 2.

It is also important to determine the main goals of the tax administration reform strategy. These would depend on the size of the tax gap. The main goals are to maintain the existing compliance level while reducing the cost of compliance and tax collection; to obtain gains in compliance by improving key procedures; to obtain significant gains in compliance by considerably modifying the approach to tax administration; and, to obtain significant gains in compliance by revamping the current tax administration procedures.⁹⁶

⁹³Silvani, C. and Baer, K. (1997) *supra*, p. 4.

⁹⁴ Ibid.

⁹⁵*Ibid*, pp. 6-8.

⁹⁶*Ibid*, p. 9.

Silvani and Baer proceed to give ten guiding principles that need consideration in designing a reform strategy as hereunder.

- a. Political commitment to and the sustainability of the reform are crucial. The Government must be politically committed to the reform and the reform measures must be politically sustainable.
- b. Simplify the tax system to facilitate administration and reduce compliance costs. The importance of simplifying the tax system in order to enhance the effectiveness and efficiency of the tax administration requires emphasis. Complex and opaque laws also make it difficult for taxpayers to comply and raise compliance costs.
- c. Encourage voluntary compliance. Tax administration should encourage voluntary compliance and address the obstacles that prevent voluntary compliance.
- d. Formulate a clear strategy.
- e. Identify the tax and accounting laws that require change.
- f. Take an integrated approach to the tax collection process. To achieve a significant improvement in the overall effectiveness of the tax administration, each element of the tax collection process needs to be improved.
- g. Differentiate the treatment of taxpayers by size.
- h. Ensure the effective management of the reform process.
- i. Set priorities and establish a timetable.
- j. Begin fundamental reform with pilot projects. A successful pilot project can serve as a blueprint for overall tax administration reform.⁹⁷

The foregoing list is an important guide to designing a reform strategy and towards benchmarking.

A detailed strategy will have to identify specific bottlenecks and formulate concrete measures to deal with problems in taxpayer registration; tax returns and payments processing; computer operations; detection of stop filers and collection of arrears;

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⁹⁷*Ibid*, pp. 9-17.

delinquent taxpayers; audit; the sanctions and penalty system; taxpayer services and publicity; management and organization; and personnel.⁹⁸

According to KRA, a major objective of revenue administration reform is to enhance efficiency and effectiveness of the tax system by improving the compliance rate and reducing the cost of tax administration and compliance.⁹⁹

Steinmo observes that there were marked and persistent trends common to reforming nations in the 1980s and 90s. He examines the politics of tax reform in Britain, Sweden and the United States and then makes observations about general features of the politics of tax reform. Several changes in the political economy led to widespread tax reform measures. These included inflation and economic growth; change in intellectual ideas; and the increasing internationalisation of the world economy.¹⁰⁰

There are three salient factors that affect the shape and character of any nation's tax reform. These are the political structure, the tax structure and the political and administrative leadership. The first has implications for both the process of reform and the policy outputs. The second is critical to understanding the goals which the reform is supposed to achieve and the third affects how the general disaffection with the current tax system is translated into specific policy reforms.¹⁰¹

Bird identifies three basic rules of reform. They are as follows: -

1. Rule of Results

This postulates that what is important in appraising any tax change are its effects in the context of the particular country in question, not whether the change moves the tax system closer in some sense to some predetermined standard or other. This has been recognized as the most important rule. The

⁹⁹KRA (2010) *supra*, p. 11.

⁹⁸*Ibid*, pp. 17-31.

¹⁰⁰Steinmo, S. (1995) *supra*, pp. 182-184.

¹⁰¹*Ibid*, pp. 185-186.

result depends on the object of imposing the particular tax. If, for instance, the object was raising revenue, then the result can be measured by the increase in revenue.¹⁰²

2. Rule of Relevance

This rule is to the effect that reform should be relevant not only in terms of results in the specific context for which they are proposed but also with respect to some policy objective. Consequently, the effort needed to accomplish any tax change should be reserved for changes relevant to development objectives. This rule cannot be considered in isolation from the rule of results. Indeed, the two rules are intertwined and demand the same analysis.¹⁰³

3. Rule of Robustness

For reform measures to achieve the desired results, they should not depend to a significant degree on uncertain factors such as assumed tax incidence or an assumed relationship between such unknown magnitudes as, for example, the elasticity of factor substitution and the elasticity of labour supply. Further a number of ways should be proposed to achieve particularly desired policy objectives. Lastly, the policies should offer as little latitude as possible for officials to avoid their mistakes or failures to affect outcome. The effect of this rule is that the discretion of tax administrators should be reduced as much as possible.¹⁰⁴

Two subsidiary or auxiliary rules have also been postulated as an instrumental way of meeting the three basic rules of reform. These are:-

¹⁰² Bird, R. M. (1992) *Tax Policy and Economic Development*, The John Hopkins Press, London, p. 183.

¹⁰³*Ibid*, p. 184.

¹⁰⁴*Ibid*, pp. 184-185.

a. Rule of Redundancy

This holds that the appropriate tax policy for development generally requires the orchestration of many subtle fiscal instruments due to the multiplicity of policy objectives. This rule appears to be geared more towards policy than legislation.¹⁰⁵

b. Rule of Resiliency

This requires that a certain degree of institutionalization of the tax reform process be effected, for example, in the form of a special unit for the continual review and adjustment of the tax system. A resilient attitude to adaptation will ensure that what emerges at the end of the process bears some relation to what was initially intended. This is to ensure that policy makers have the capacity to alter and adjust their policies to suit changing needs and circumstances.¹⁰⁶

The administrative dimension should be placed at the centre rather than the periphery of tax reform efforts. The most rewarding approach to tax reform in most countries is to design a tax system that can be acceptably implemented by the existing weak administration.¹⁰⁷

The solutions to administrative problems of tax reform are divided into three groups: those that would change the environment; those that would change the administration; and those that would change the law.¹⁰⁸

According to Bird, there are three ways to approach the question of modifying the legal structure to accord with the administrative realities of developing countries: to develop some gadgetry to bypass the problem; to provide an adequate legal structure for administration; and to design the basic tax law properly in the first place. He holds that the first is a false lead and the second is inadequate. ¹⁰⁹

¹⁰⁵Bird, R. M. (1992) *supra*, pp. 184-185.

¹⁰⁶Ibid.

¹⁰⁷*Ibid*, p. 189.

¹⁰⁸*Ibid*, p. 193.

¹⁰⁹*Ibid*, pp. 199-200.

Devereux holds that the three important issues in the choice of a tax system are economic efficiency, equity and administration.¹¹⁰

Karingi & Wanjala observe that one of the key reasons for undertaking tax reforms in Kenya has been to create a sustainable tax system that could generate adequate revenue to finance public expenditures.¹¹¹ In their paper, they examine the reform efforts of the country and review the strengths and weaknesses of the tax system as it has evolved over past decades. They, however, concede that they did not cover the question of tax administration reforms.¹¹²

The literature available identifies guiding principles for designing a tax reform strategy. It also discusses what are referred to as the basic rules of reform. However, case studies are unavailable for the implementation of these principles and rules in Kenya or in an African context. The rules are also more relevant to substantive tax reform.

The available literature on tax administration reforms is thin on Kenya. As noted, designing a reform strategy requires the consideration of the peculiar circumstances of each country.

1.5.4 Taxpayer Identification and Registration

Taxpayer identification and registration form a key plank in modern tax administration. This is necessary due to the sheer number of taxes and taxpayers involved and the systems in place.

Several key questions should be addressed: what types of controls are established to check that no Taxpayer Identification Number (TIN) is assigned to more than one taxpayer, and that each taxpayer is assigned only one TIN? Which taxpayers must

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¹¹⁰ Devereux, M. P. (ed.) (1996) *The Economics of Tax Policy*, Oxford University Press, Oxford, p. 10.

¹¹¹Karingi, S. N. and Wanjala, B. (2005) *The Tax Reform Experience of Kenya*, UNU-WIDER Research Paper No. 2005/67, UNU-WIDER, Helsinki, p. 13.

¹¹²*Ibid*, p. 21.

be registered? What measures are in place to register businesses in the informal sector?¹¹³

One of the major problems is the over-registration of taxpayers, with only a small percentage actually filing and paying taxes. This makes it more difficult to identify and monitor taxpayers who should contribute a significant amount of revenue, and creates an unproductive workload for the tax administration. It is proposed that a reasonable registration threshold should be established to avoid over-registration. However, it is the position of this study that the concept of over-registration is a misnomer. There is need to register as many taxpayers as possible not only to collect taxes from them but also as a means of creating an audit trail when they deal with other taxpayers.

In a country with a large informal economy, there is need to bring businesses in the informal economy into the tax net. There are two main ways of detecting unregistered taxpayers. The first approach is to audit registered taxpayers in order to detect their unregistered suppliers or customers. The second approach involves searches or inspections in which a group of officials goes door-to-door within a particular geographical area, checking that all persons or establishments engaged in a taxable business activity in that area are properly registered.¹¹⁵

Insufficient vigilance and poor registration practices often thwart TIN or PIN primacy and effectiveness. The integrity of the PIN register is seriously degraded where it is associated with lax registration procedures or the failure to institute robust proof of identity requirements. This is particularly observed where PIN usage is extended to many noncore tax activities such as the payment of minor fees or fines, obtaining a licence, opening a bank account or bidding for a government contract. Unless there is tight vetting, individuals or entities often obtain multiple registrations, usually with slightly differing or incomplete information.¹¹⁶ In a country like Kenya where the

¹¹³Silvani, C. and K. Baer (1997) *supra*, p. 17.

¹¹⁴*Ibid*, p. 18.

¹¹⁵*Ibid*.

¹¹⁶Kloeden, D. (2011) *supra*, p. 31.

uptake of PIN registration is still low, it helps to use the PIN in accessing public services as a means to enforce compliance.

The key challenge the literature has not dealt with is the integration of the PIN allocated by the national ARA with the county tax administration system. Should counties allocate other numbers or should they use the one allocated by the national ARA and hence get access to the system? What would the latter mean for data security?

The concept of over-registration also needs to be addressed with direct relevance to the Kenyan situation.

1.5.5 County Tax Administration

It has been observed that one of the most important questions of intergovernmental fiscal relations is "who (which level of government) should tax what?" referred to as the "tax assignment problem." However, this question alone fails to adequately describe the tax assignment problem. It is therefore necessary to add "and how?"

McLure goes on to observe that a full description of tax assignment involves identifying which level chooses the taxes that a given level imposes; which defines the tax bases; which sets tax rates; and which administers the various taxes. There will be vertical fiscal imbalance if the subnational governments lack control over all these decisions, especially control over tax rates. The constitutions of some countries identify specific taxes that various levels of government are allowed to levy and/or those that are prohibited.¹¹⁸

The Constitution of Kenya, 2010, identifies the specific taxes for the two levels of government. Article 209(1) provides for the national government to impose income tax, value added tax, customs duties and other duties on import and export goods,

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¹¹⁷McLure, C. E., Jr. (2001) "The Tax Assignment Problem: Ruminations on how theory and practice depend on history", *National Tax Journal*, Vol. 54, Issue No. 2, p. 2.

¹¹⁸*Ibid*.

excise tax, and any other tax not under the mandate of county governments. Sub-Article (3) empowers counties to impose property rates, entertainment taxes and any other tax that it is authorized to impose by an Act of parliament. The Constitution, however, subordinates the powers of the counties to the national interest. Article 209(5) provides:

"The taxation and other revenue-raising powers of a county shall not 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."

It is noteworthy that Article 207(1) of the constitution establishes a Revenue Fund for each county into which all taxes and other revenue will be paid.

According to Bahl and Bird, subnational governments in developing countries require much more real taxing power than they now have if decentralization is to produce sustainable net benefits. An important benefit from decentralization is the increased efficiency that comes from moving governance closer to the people.¹¹⁹

Revenue assignment in a multilevel government structure is often controversial. The problem is twofold. The central government can collect most taxes more efficiently than can subnational governments; and, the potential tax bases available to the subnational government vary widely from jurisdiction to jurisdiction. The first problem gives rise to vertical imbalance whereas the second produces horizontal imbalance.¹²⁰

Martinez-Vazquez and Timofeev attempt an exposition of what to look for in choosing between centralized and decentralized models of tax administration. The fundamental issues they address concern the most appropriate approach to organizing the vertical structure of tax administration and the determinant factors that

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¹¹⁹Bahl, R. and Bird, R. (2008) "Subnational Taxes in Developing Countries: The Way Forward", *Public Budgeting & Finance*, pp. 2-3.

¹²⁰*Ibid*, p. 6.

may make an approach more or less optimal in any particular country. 121 The perspective of the paper is limited in that it mainly deals with the question of the level of government that would be responsible for the administration and enforcement of the different taxes.

The county system of government is a new introduction in the management of public affairs in Kenya. It is an introduction of the Constitution of Kenya, 2010. The enabling legislation for county tax administration is yet to be enacted. As such, it is an area of uncertainty as no literature on Kenya exists.

The literature available delves a lot into the determination of the level of government that ought to impose what tax. This has been sorted out by the Constitution of Kenya, 2010, and therefore all that remains is the question of "how".

1.5.6 Benchmarking Tax Systems

Benchmarking refers to the formulation of rules or construction of parameters against which various positions or options can be measured. The purpose of this is to check whether the said position or option meets a certain desired standard.

There is no benchmarking methodology that is generally agreed upon for the assessment of tax systems. Different methodologies lay emphasis on different considerations.

Gallagher notes that there has been very limited effort to develop comprehensive tools for assessing tax systems. This is notwithstanding the fact that tax systems have been undergoing assessments over a long period of time. The various attempts either fail to provide international comparator information or verifiable indicators. 122

¹²¹ Martinez-Vazquez, J. and Timofeev, A. (2005) Choosing between Centralized and Decentralized Models of Tax Administration, Andrew Young School of Policy Studies Research Paper Series, Working Paper 06-49, p. 1.

¹²² Gallagher, M. (2004) Assessing Tax Systems Using a Benchmarking Methodology, Research Paper for the Fiscal Reform in Support of Trade Liberalization Project, Development Alternatives, Inc., Washington, pp. 1-2.

In his own words, Gallagher's paper goes beyond previous attempts and "presents benchmarking as a tool for assessing both tax system performance and the inputs and systems of any tax administration." He explains thus:

"It is a means of comparing a set of specific indicators that capture the essence of any tax system to either international best or perhaps most relevant practices. The system also helps to facilitate establishing goals and specific targets for tax system improvement and modernization." ¹²³

The benchmarking methodology was first applied in Guatemala in 2001. The team that took part in the study included two public finance economists, one tax administration consultant, one computer systems consultant and one customs administration consultant. It is noteworthy that there was no legal consultant in the team. Accordingly, it is likely that legal perspectives to benchmarking were ignored.¹²⁴

The identified benchmarks are tax structure and performance; organization; legal framework; enforcement; receipts and collection; and, systems and resources. It is observed that the importance of establishing benchmarks is to appraise tax authorities on what needs to be done to improve their tax administrations.¹²⁵

A major shortcoming of the study is that it admits that the methodology can only be used for national-level tax systems. This means that its applicability to county (subnational) tax systems has been doubted by its proponents. Its other limitation is that it has only been applied wholesome in Latin America. The only attempt to apply it in Africa was its partial application in Tanzania and the application of its abbreviated version in Egypt. 126

¹²³*Ibid*, p. 3.

¹²⁴Gallagher, M. (2004) *supra*, pp. 5-6.

¹²⁵*Ibid*.

 $^{^{126}}Ibid.$

As noted above, the literature on benchmarking does not address benchmarking at the county (subnational) level. There is also very little on benchmarking tax administration systems that can be used as a tool for reform in Kenya. Therefore, this study will be daring to go a step further in forbidden territory and suggest implementable strategies for the counties.

1.5.7 Literature Review in Perspective

This study uses a thematic approach to literature review. The themes isolated for the review were those deemed directly relevant to the instant study and include autonomous revenue agencies; electronic service delivery; tax administration reform; taxpayer identification and registration; county tax administration; and, benchmarking tax systems.

It is noteworthy that no literature that directly relates to the substance of this study exists. This can be explained by the fact that the devolved system of government is a new phenomenon in Kenya and as such is yet to crystallize. Accordingly, any literature relevant to Kenya relates to the national system of taxation or the form of decentralization that hitherto existed.

This study therefore goes into an area that is deficient in literature as an attempt to be a building block towards further research.

1.6 DELIMITATIONS AND LIMITATIONS OF THE STUDY

The scope of this research is the administration of county taxes and not charges and other levies. Whereas the latter constitute revenue, they are not taxes. The regime for administration of charges and other levies is somewhat different as they usually relate to specific services provided by government offices.

This research has no intention to make proposals on the administration of taxes at the national level. The systems of national tax administration studied herein are meant to aid in understanding the country's tax administration environment to be able to understand the likely environment at the county level.

This study faced the challenge of a lack of literature on county taxation in Kenya, especially because counties are new administrative units. This challenge was surmounted in a three-pronged approach: using literature in respect of the hitherto existing local authorities in Kenya, using literature on national tax administration and attempting to juxtapose it to the circumstances of counties, and using literature relating to subnational taxation in other jurisdictions.

1.7 PROFILE OF THE STUDY

Chapter two gives a constitutional and historical background on the devolved system of government in Kenya. It also provides the conceptual and theoretical framework that informs this study.

Chapter three discusses taxpayer identification and registration as a tax administration tool. It delves into the rationale, the concept of information sharing and the PIN in Kenya. In it, the devolution of the PIN system is considered. This chapter addresses the question whether the PIN used at the national level by KRA is suitable for the administration of county taxes in Kenya.

Chapter 4 deals with the concept of autonomous revenue authorities. It looks at why they have become common especially in Africa. It also explores the operations of the Kenya Revenue Authority and the possibility of devolving its services to the counties, or the possibility of having similarly conceived agencies at county levels. The question addressed by this chapter is whether the concept of ARAs is suitable for the administration of county taxes in Kenya.

Chapter five is concerned with the use of electronic and automated systems as a means of achieving efficiency in tax administration. It deals specifically with the ITMS, Simba 2005 System, and the ETR. The discussion on these systems informs the study on possible automation at the county level. The research question this

chapter seeks to address is whether the electronic and automated systems in use by KRA are suitable for the administration of county taxes in Kenya.

Chapter six explores the issue of county taxes and their administration. It deals with property rates, entertainment taxes and other county taxes. Further, it also discusses the application of the principle of national interest in the administration of county taxes. This chapter addresses the question on the lessons that we can draw from past tax administration reforms in Kenya to aid in developing models for administration of county taxes.

Chapter seven concludes the study by giving proposals for reform. It begins with identifying the lessons from what is covered in the study and uses that to come up with proposals. It also concludes the entire work.

CHAPTER TWO

CONSTITUTIONAL BACKGROUND AND A CONCEPTUAL AND THEORETICAL FRAMEWORK

This chapter begins by giving a constitutional and historical background to the devolved system of government, of which the county is the central institution. The purpose for this is to put into perspective the tax administration aspect of this unit of government. The chapter then discusses a conceptual framework and the theoretical framework that underpins the study. The law and development discourse is introduced as the underlying discourse in this study.

2.1 CONSTITUTIONAL BACKGROUND

The devolved system of government is a concept in the Constitution of Kenya, 2010, that divides the territory of Kenya into 47 Counties. Whereas the national and county governments are distinct, they are interdependent and are required to conduct their mutual relations on the basis of consultation and cooperation. 128

The Constitution of Kenya, 2010, is a product of a long constitution making experience in Kenya. This can be traced back to the pre-independence Lyttelton, Lennox-Boyd and Lancaster House Constitutions, through the Independence Constitution and the numerous amendments made to it. The Independence Constitution had a devolved system of government (*majimbo* system) with the regions or *jimbos* being the units of devolution. This system was first weakened by the first amendment through the Kenya Amendment Act No. 28 of 1964 and

 ¹²⁷ These are listed in the First Schedule as follows: Mombasa, Kwale, Kilifi, Tana River, Lamu, Taita/Taveta, Garissa, Wajir, Mandera, Marsabit, Isiolo, Meru, Tharaka-Nithi, Embu, Kitui, Machakos, Makueni, Nyandarua, Nyeri, Kirinyaga, Murang'a, Kiambu, Turkana, West Pokot, Samburu, Trans Nzoia, Uasin Gishu, Elgeyo/Marakwet, Nandi, Baringo, Laikipia, Nakuru, Narok, Kajiado, Kericho, Bomet, Kakamega, Vihiga, Bungoma, Busia, Siaya, Kisumu, Homa Bay, Migori, Kisii, Nyamira and Nairobi City.
 128 Constitution of Kenya, 2010, Article 6.

¹²⁹ The term *majimbo*, which means regionalism, is generally associated with divisive tribal politics in Kenya. This was the line used to abolish it and was used thereafter to fight off any proposals for a devolved or decentralized system of government.

eventually abolished by the third amendment through the Constitution of Kenya (Amendment) Act No. 16 of 1965. 130

Devolution is a form of decentralized government, the others being de-concentration and delegation. The distinguishing feature between devolution and other forms of decentralization is that in devolution there is transfer of political, administrative and legal authority, power and responsibility to quasi-autonomous local units. This includes fiscal devolution. 131

Prior to the Constitution of Kenya, 2010, Kenya operated under a de-concentrated system of local government. Under this system, the local units were the municipal councils, county councils, town councils, urban councils and area councils. These were headed by mayors (for municipal) and chairmen (for the others), who were elected by the councillors from amongst their number. The councils operated under the supervision of the Minister for Local Government, who wielded wide powers including that of dissolution. They had limited legislative powers. They could enact bye-laws, which had to be approved by the Minister and which had to be in consonance with the parent Act. The local authorities had the power to collect property rates but this power was still subject to ministerial control. 132

Devolution has been hailed as a constitutional means towards equal distribution of national resources and reduction of poverty. It brings services closer to the citizenry and as such enhances accountability and transparency. It is argued that through fiscal devolution, development is taken closer to the people by involving them in policy making. The cost of implementing devolution is yet to be fully appreciated. If this cost exceeds by substantial margins the cost of running the previous system of

¹³⁰ For a comprehensive exposition of the Kenyan constitution-making experience, see Ghai, Y. P. & J. P. McAuslan (1970) Public Law and Political Change in Kenya: A study of the legal framework of government from colonial times to the present, Oxford University Press, Nairobi; Muigai, G. (2001) "Constitutional Amendments and the Constitutional Amendment Process in Kenya (1964-1997): A study in the politics of the Constitution", unpublished PhD Thesis, University of Nairobi, Nairobi; and, Lumumba, P. L. O. "A journey through time in search of a new Constitution" in Lumumba, P. L. O., M. K. Mbondenvi and S. O. Odero (eds.)(2011) The Constitution of Kenya: Contemporary Readings, Law Africa, Nairobi.

¹³¹ Odero, S. O. "Devolved Government" in Lumumba, P. L. O., M. K. Mbondenyi & S. O. Odero (eds)(2011) supra, pp. 203-207.

See the Local Government Act (Cap. 265, Laws of Kenya) (Repealed).

government, then this would translate into the need for raising higher public revenue to sustain the system of governance. 133

The object of devolution in Kenya includes the promotion of democracy, development and facilitation of decentralization. 134 As a facet of facilitating decentralization, counties must pursue fiscal stability through efficient administration of the taxes under their jurisdiction. The totality of the system should work towards development.

A county is administered by a county government which comprises of the county assembly and the county executive. It is expected that county governments would further decentralize their functions and services to smaller units of governance. The executive function is vested in the County Governor, the deputy County Governor and the County Executive Committee, while the County Assembly has the legislative authority. 135

2.2 CONCEPTUAL FRAMEWORK

The main purpose of county taxes is raising of revenue for the fiscal stability of counties. Whereas the constitution assigns these taxes, the question of their viability (generally, and in some counties) is yet to be addressed. However, with the basis of the taxes being constitutional, this study takes the position that its purview is the administration of these taxes based on the constitutional assumption of viability.

¹³³ Odero, S. O. (2011) *supra*, pp. 222-224.

¹³⁴ Article 174 of the Constitution of Kenya, 2010, provides:

[&]quot;The objects of the devolution of government are-

⁽a) to promote democratic and accountable exercise of power;

⁽b) to foster national unity by recognizing diversity;

⁽c) to give powers of self-governance to the people and enhance the participation of the people in the exercise of the powers of the State and in making decisions affecting them;

⁽d) to recognize the right of communities to manage their own affairs and to further their development;

⁽e) to protect and promote the interests and rights of minorities and marginalised communities;

⁽f) to promote social and economic development and the provision of proximate, easily accessible services throughout Kenya;

⁽g) to ensure equitable sharing of national and local resources throughout Kenya;

⁽h) to facilitate the decentralization of State organs, their functions and services, from the capital of Kenya;

⁽i) to enhance checks and balances and the separation of powers." Constitution of Kenya, 2010, Articles 176-185.

In this section, this study identifies and discusses various concepts that are relevant to tax reform so as to lay an informed basis for the substantive chapters that follow.

2.2.1 The Tax Gap

Designing a tax administration reform strategy requires a clear understanding of the administration's overall effectiveness. The size of a country's tax gap is a widely recognized measure of the tax administration's effectiveness. The tax gap is the difference between the taxes actually paid and the taxes which should be paid according to the existing laws and statutes, and includes taxes not paid due to tax evasion, tax arrears, the shortfall in taxes due to taxpayers' misunderstanding of the tax laws and any other form of non-compliance. ¹³⁶

The tax gap is also referred to as the tax collection efficiency ratio. This is the tax revenue as estimated vis-à-vis the tax revenue as actually collected. The tax administrator has to do his calculations, based on provisions of the law and government fiscal expectations to get the tax performance.

A country's tax gap is only an indicative measure often based on estimated data and sampling techniques. A precise measure is normally difficult to obtain due to the lack of accurate and up-to-date statistics needed to estimate the potential tax base and elasticity. However, a general notion of the tax gap's order of magnitude and its trend is needed for the determination of the general reform strategy to be followed. The general rule is that the larger the tax gap, the more radical the changes that need to be considered in the strategy. However, this would largely depend on the reason for the large tax gap. As will be seen in Chapter 6, the tax gap in the defunct local authorities was quite high and as such radical changes were needed in the reform of the system.¹³⁷

If countries are grouped according to the degree of tax administration effectiveness, four broad categories emerge.

¹³⁶Silvani, C. and Baer, K. (1997) *supra*, pp. 5-6.

¹³⁷*Ibid*.

The first category includes countries whose administrations are very effective and the tax gap is very narrow, in the range of 10 percent or lower. This category includes countries such as Denmark, New Zealand and Singapore. For these countries, the strategy would be geared towards maintaining a high level of compliance while trying to increase efficiency by reducing the cost of collection and taxpayers' cost of compliance.¹³⁸

In the second category are countries where tax administration is relatively effective but the tax gap is in the 10 to 20 percent range and therefore there is room for improving their effectiveness. This category includes countries such as Canada, the United States, some Western European countries and Chile. For these countries, the general approach to tax administration may be adequate and the attitude of the taxpaying population towards compliance positive. The reform strategy would be to increase compliance levels. ¹³⁹

A third category includes the vast majority of countries (including both developing and developed countries), which have relatively ineffective tax administrations and a tax gap in the range of 20 to 40 percent of the potential tax. In these countries, improving the effectiveness of the tax administration should be a major concern, and the general approach to tax administration should be critically analyzed. Major organizational, procedural and management reforms are required. The Kenyan tax system falls under this category. However, as will be seen in Chapter 6, if the system under the defunct local authorities is considered on its own, then it would definitely fall under the fourth group below. ¹⁴⁰

A fourth group consists of countries with a highly ineffective tax administration and tax gap in the range of 40 per cent or more of the potential tax. In such countries, the strategy needs to be quite comprehensive and a complete revamping of the tax administration is called for. The strategy should consider the phasing out of obsolete

¹³⁸Silvani, C. and Baer, K. (1997) *supra*, p. 7.

 $^{^{139}}Ibid.$

¹⁴⁰*Ibid*, pp. 7-8.

tax administration concepts and practices that they may be using and the adoption of a completely new foundation.¹⁴¹

This measurement technique is fallacious. It uses too much of generalisations and averages. As a result, it fails to capture the performance of specific taxes. Further, it is not always easy to come up with the estimated tax revenue in a scientific manner especially because one of the reasons that some revenue is not collected is because the taxpayers have not been properly identified.

For the tax gap to be used as a measure to determine the reform needs of counties in Kenya, it would require the use of the data used by the defunct local authorities. This cannot be a reliable source as the county taxes as fashioned today were not under the ambit of the defunct local authorities in the same form. Further the systems to be used are under different supervisory regimes, previously under a deconcentrated system but currently under distinct devolved units. Accordingly, for the purposes of this study we use this concept to understand national tax reform measures. However, it is a good indicator of the shortcomings of the defunct system and as such can be used to project the extensive nature of reforms needed.

2.2.2 Canons of Taxation

Adam Smith in *The Wealth of Nations* identified four canons or principles of taxation as follows: -

- i. Taxes should be levied on individuals according to their ability to pay as reflected by income.
- ii. Taxes should be certain as to amount and condition of payment.
- iii. Taxes should be payable at a time and in a manner convenient to the taxpayer.
- iv. Taxes should be collectible at a low or economical cost. 142

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¹⁴¹*Ibid*, p. 8.

¹⁴² Smith, A. (1778-79) *An Inquiry into the Nature and Causes of Wealth of Nations*, 2nd ed. W. Straham and T. Cadel, London, generally.

Later writers changed the emphasis on these principles and paid greater attention to considerations of equity between taxpayers; the effect of the tax system on economic growth and efficiency; and, its effect on economic stability.¹⁴³

From the foregoing, taxation is generally governed by the principles of certainty, neutrality, simplicity, efficiency and economy. The principle of certainty is to the effect that a prospective taxpayer should be able to know what taxes are applicable to him. A taxpayer should not be subjected to the arbitrary decisions of the authorities. Neutrality provides that taxes should be applied equally on the subject matter which has been identified as taxable. The principle of simplicity requires a tax system to be capable of being understood easily by persons subject to it and promote convenience to taxpayers. This lends strong support to certainty. The principle of economy is to the effect that a tax must be economical to collect and with minimal compliance cost. A tax system should also be equitable and promote economic growth and stability. A tax system is said to be feasible when it complies with these canons.

Over time, the canons of taxation have become, to a certain extent, outdated. These canons served agrarian economies. Simplicity is no longer an issue. Whereas one can strive to be certain, one cannot guarantee certainty, especially where tax is a budgetary process. Whereas the inventory of taxes was quite limited during the times of Adam Smith, now taxation entails the dynamics of various harvests. Accordingly, whereas the canons of taxation are of great historical importance, they cannot entirely form the basis of modern day tax reform.

The foregoing notwithstanding the canons of taxation still form a good starting point in tax reform. Some principles such as certainty and economy are still relevant. It is

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Rutherford, D. (1995) Routledge Dictionary of Economics, Routledge, London, p. 57; McGraw-Hill Inc. (1973) The McGraw-Hill Dictionary of Modern Economics (2nd ed.) McGraw-Hill Book Company, New York, p. 73; and Sloan, H. S. & Zurcher, A. J. (1964) A Dictionary of Economics (4th ed.) Barnes & Noble Inc., New York, p. 45.

¹⁴⁴Boreham, G. F. (1971) Contemporary Economic Thinking, Holt, Rinehart & Winston of Canada Ltd, Toronto & Montreal, p. 338.

¹⁴⁵Ibid, p. 339.

arguable that perhaps some modern day tax reform measures fail because of ignoring some of these principles. In this study therefore we do not take for granted these canons but we adapt them for use where relevant.

2.2.3 The Concept of Subnational Taxes

A subnational tax is one that operates within a jurisdiction that is itself part of a national jurisdiction or a state as recognized under international law. It may also be referred to as a local tax. Under the Constitution of Kenya, it is known as a county tax.

For a tax to qualify as a 'totally' subnational tax, it has to satisfy five distinct conditions. These are that the subnational government:

- a) can decide whether to levy the tax or not;
- b) can also determine the precise base of the tax;
- c) can decide the tax rate;
- d) administer(assess, collect, enforce) the tax; and,
- e) get to keep all the revenue they collect. 146

It is, however, unlikely that the so-called subnational taxes satisfy all the conditions. Indeed, many do not and only satisfy one or two conditions. It has been argued that the most critical aspect of subnational taxing power is who is politically responsible for setting the tax rate. It has been argued that the most critical aspect of subnational taxing power is who is politically responsible for setting the tax rate.

As will be seen in Chapter 6, the Constitution of Kenya provides that counties may impose property rates, entertainment taxes and any other tax that may be authorized by an Act of Parliament. It expressly exempts national taxes from the jurisdiction of

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¹⁴⁶ Bird, R.M (2011) "Subnational Taxation in Developing Countries: A review of the Literature", *Journal of International Commerce, Economics and Policy*, Vol. 2, No. 1 (2011) 131 – 161, p. 144.

¹⁴⁷ Ibid. See also OECD (1999) Taxing powers of State and Local Governments, Paris and Bird, R. M. & E. Slack (2002) "Land and Property Taxation: A Review", p. 11 on these conditions and the observation that very few countries have such taxes.

¹⁴⁸Bird, R.M (2011) *supra*, p. 145.

the counties. The exposition in Chapter 6 will assist us to understand whether these county taxes satisfy the conditions above to make them 'totally' subnational taxes.

2.2.4 The Question of Tax Assignment

The guestion of tax assignment deals with "who (which level of government) should tax what?" This is a problem that must arise when dealing with intergovernmental fiscal relations. 149

The constitutions and legislations of different countries deal with this problem. The constitutions of some countries identify the specific taxes that various levels of government are allowed to levy and/or those that are prohibited. 150

A key rule identified is that the appropriate way to assign taxes in any country depends on how spending responsibilities have been assigned.¹⁵¹ Where the constitution has expressly assigned the taxes, then it is deemed that this consideration has been settled.

As will be seen in Chapter 6, Article 209 of the Constitution of Kenya, 2010, attempts to settle the question of tax assignment. It expressly provides that counties may only impose property rates, entertainment taxes and other taxes authorized by national legislation. The Constitution therefore assigns the taxes, and for purposes of the future, empowers Parliament to assign any new taxes.

Whereas the Constitution assigns the taxes, these taxes are simply conjecture. The Constitution does not define and delineate them. They may be open to diverse interpretation. The safest way is to follow tradition as to what those terms have been taken to mean in the past, though under a different regime. In Chapter 6, this study attempts to address this issue.

¹⁴⁹McLure, C.E. Jr (2001) "The Tax Assignment Problem: Ruminations on how theory and practice depend on history," National Tax Journal, Volume 54, Issue 2, p. 2.

¹⁵⁰*Ibid*.

¹⁵¹Bird, R.M (2011) *supra*, p. 145.

2.2.5 The Concept of Tax Culture

A country's tax culture is the amalgam of the tax system, the actual tax practice and the unique relationship between the tax authorities and the taxpayers' accounts of its uniqueness. 152

Birger Nerre offers the following definition:

"A country-specific tax culture is the entirety of all relevant formal and informal institutions connected with the national tax system and its practical execution, which are historically embedded within the dependencies and ties caused by their ongoing interaction". ¹⁵³

Tax reforms led by foreign tax experts have rarely been successful as they fail the compatibility test with the national tax culture. Though the tax missions were fashionable beginning the 20th century, they rarely resulted in a successful enforcement and continuity of changes. They lead to a clash of different cultures and divergent tax systems. Two different kinds of disturbances of tax culture have been identified: tax culture shocks and tax culture lags. Both are due to ignorant and/or ethnocentric policy measures.¹⁵⁴

Tax culture shocks can emerge during an encounter with an unknown or foreign tax culture. This may either be on the individual or micro-level, or the collective or macro-level. Collective tax culture shock has a negative effect on the entire tax reform initiative.¹⁵⁵

Lags are almost inevitable. They occur during any transformation or reform process. This is because tax reform means to change one part of a nation's tax culture first, that is, the formal institution of law. The remaining parts of the tax culture stay

¹⁵²Nerre, B. (2008) Tax Culture: A Basic Concept for Tax Policies," *Economic Analysis & Policy*, Vol. 38 No.1 March 2008, p. 154.

¹⁵³*Ibid*, p. 155.

¹⁵⁴*Ibid*, p. 153.

¹⁵⁵*Ibid*, p. 155.

unchanged for the time being and lag behind in the tax culture's evolution. This leads to a tax culture lag. 156

Ogburn defines the culture lag phenomenon as follows:

"A cultural lag occurs when one of two parts of culture which are correlated changes before or in greater degree than the other part does; thereby causing less adjustment between the two parts than existed previously". 157

In tax reform, the prevention of collective culture shocks should be a normative criterion for good and sound tax policies. It is also important to understand that tax culture lags are almost inevitable. However, the degree of negative effects depends on the extent of tax – cultural conformity of new and reformed tax measures.¹⁵⁸

2.2.6 Patriotism and Taxation

Patriotism plays an important role in public finance. Indeed the role of patriotism in enabling the government achieve its taxation goals has been recognized.¹⁵⁹

It has been suggested that patriotism is an important ingredient in tax administration as it may simplify tax collection through higher compliance even in the absence of thorough tax auditing. Patriotism has a large positive effect on tax compliance because honest tax compliance is, to a certain degree, a matter of choice.¹⁶⁰

It has however been recognized that whereas the quantitative effect of patriotism is substantial, it is not necessarily the most important reason for high tax compliance.

157 Ogburn, W.F. (1957 [1964]) "Cultural Lag as a Theory" Sociology and Social Research 41:167 – 174, p.
 167 [86] as quoted in Nerre, B. (2008) supra, p. 160.

¹⁵⁶*Ibid*, p. 160.

¹⁵⁸Nerre, B. (2008) *supra*, p. 164.

¹⁵⁹ Konrad, K. A. & S. Qari (2009) *The Last Refuge of a Scoundrel? Patriotism and Tax Compliance*, IZA Discussion Paper No. 4121, p. 2.

¹⁶⁰*Ibid*, pp. 3 and 26.

All the same, however, its impact makes more patriotism a desirable aim for a revenue-oriented government.¹⁶¹

In certain jurisdictions, especially the US, patriotism has been seen to be a weak tax compliance factor. This is because, naturally, patriotism in former colonies has strong anti-tax roots.¹⁶²

In the US, challenging taxes is seen as an act of patriotism, or at least, a patriotic defence of citizen rights against the tyranny of taxation. This has led to the argument that patriotism has no proper role in determining a citizen's taxpaying obligations. ¹⁶³

Citizens are more likely to comply with tax laws if they consider the state as legitimate and credible. Major tax reform is therefore clearly an exercise in political legitimation.¹⁶⁴ County taxes in Kenya were introduced through a Constitution that came into being through a popular referendum and it may therefore be argued that they have legitimacy and credibility.

In Kenya, the perception of taxpayers to taxation is also influenced by the way it was introduced during the colonial era. Indeed taxes served the twin role of raising revenue and forcing Africans into wage labour. The introduction of the *kipande*¹⁶⁵ system as an enforcement tool only made the situation worse. It was dehumanizing and as such attracted revolt. This, in addition to the land question, ignited the movement for the agitation for freedom.¹⁶⁶

¹⁶² Lavoie, R. L. (2011) "Patriotism and Taxation: The Tax Compliance Implications of the Tea Party Movement," *Loyola of Los Angeles Law Review*, Vol. 45: 39-86 at p. 85.

¹⁶¹*Ibid*, p. 4.

¹⁶³ *Ibid*, pp. 60-61

¹⁶⁴ Fakile, A. S., F. F. Adegbie & O. S. Faboyede (2014) *supra*, p. 106.

¹⁶⁵ A *kipande* was a cardboard plate hang on African taxpayer's neck. On it were his identification particulars and regular updates on his tax payments.

¹⁶⁶ Swainson, N. (1980) *The Development of Corporate Capitalism in Kenya, 1918-77*, University of California Press, Berkeley and Los Angeles, p. 32.

The perception of taxpayers is, however, negatively affected by corruption.¹⁶⁷ It diminishes the patriotic character of the taxpayer as he believes his taxes are going to waste. Corrupt behaviour therefore hinders effective tax administration. ¹⁶⁸

2.2.7 Reforming Tax Administration in Kenya

In Kenya, various tax administration reforms have been undertaken. These include the introduction of the Personal Identification Number (PIN), the establishment of the Kenya Revenue Authority (KRA), the use of electronic and automated systems and the introduction and implementation of the Integrated Tax Management System (ITMS). Such reforms ought to be undertaken both in accordance with the law and the known principles of taxation. The result should be an optimum tax administration system that runs effectively and efficiently.

In undertaking the various reform initiatives, KRA faced both internal and external resistance to change. This has had a negative impact on the complete implementation of the reform initiatives. Some of the reform initiatives were also not well thought out to ensure that they were relevant to the circumstances prevailing at the time.¹⁶⁹

A study of the various measures is necessary. These measures are implemented through legislation or other legal instruments. A jurisprudential system ought to be discerned from the various initiatives.

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¹⁶⁷ Osoba, S. O. (1996) "Corruption in Nigeria: Historical perspectives" *Review of African Political Economy* 69:371-386 at p. 372 defines corruption as:

[&]quot;a form of antisocial behaviour by an individual or social group which confers unjust or fraudulent benefits on its perpetrators, is inconsistent with the established legal norms and prevailing moral ethos of the land and is likely to subvert or diminish the capacity of the legitimate authorities to provide fully for the material and spiritual well-being of all members of society in a just and equitable manner."

¹⁶⁸ Mulinge, M. M. & G. N. Lesetedi (1998) "Interrogating Our Past: Colonialism and Corruption in Sub-Saharan Africa" *African Journal of Political Science*, Vol. 3 No. 2:15-28 at pp. 15-16 observe that corrupt behaviour incorporate:

[&]quot;acts such as the use of public authority, office, or official position with the deliberate intent of extracting personal or private monetary rewards or other privileges at the expense of public good and in violation of established rules and ethical considerations, theft, embezzlement of public funds or appropriation of public funds or appropriation of state property by other means, as well as nepotism or granting of favours to personal acquaintances."

¹⁶⁹ KRA (2012) Fifth Corporate Plan 2012/13 – 2014/15, p. 24.

As shown in Figure 2 below, there is a relationship between the rules of reform and the eventual outcome of the law. This should also inform the various tax administration reform measures taken. In the final analysis, using responsive rules of reform, legislating responsive law and implementing sound tax administration reform measures leads to an optimum tax system. This has a positive impact on the overall development of the country.

The intersection between the various factors is represented in the figure below.

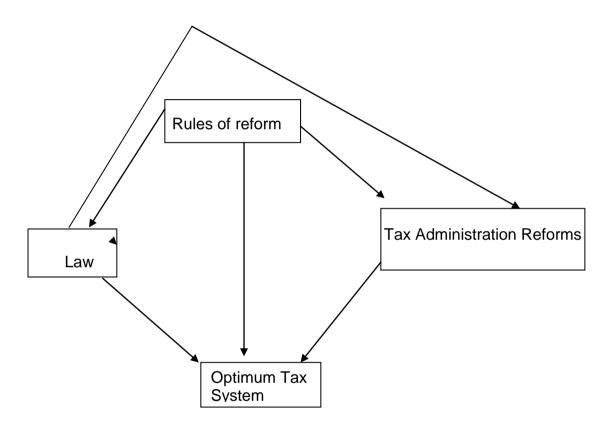


Figure 2. Conceptualised relationship between factors

The tax administration reform measures will lead to discernible principles applied in their conceptualization and implementation. The identified principles may be deliberate or happenstance. Using some basic rules of reform, it is possible to ascertain the success or effectiveness of the reform measures and by extension the principles applied. This will in turn make it possible for this study to identify lessons relevant to the Kenyan situation. This will then be used to model a strategy for a tax

administration system for the counties, with the relevant proposals for law reform. This will inform the flow of research.

2.3 LAW AND DEVELOPMENT DISCOURSE

This study has law and development as the underlying discourse. Together with the theories that follow, this discourse informs the whole spectrum of the research.

The discourse refers to 'organized efforts to transform legal systems in developing countries to foster economic, political and social development'. This is extended to also refer to the associated academic projects. This movement started in the mid-20th century and have undergone changes since then, especially in terms of ideas and priorities. However, the relationship between the legal system and the economic and social development of a country has been acknowledged since the 18th century. In the 19th century Max Weber acknowledged the relationship between the European legal systems and the development of capitalism. Narrower conceptions of 'law and development' also exist. 171

'Law' and 'development' are correlated. Law is known to have an influence on development. Whereas the term 'development' may appear to be value-free as a concept, sometimes its conceptualization differs. Whereas the dominant conception of development is econometric, this study appreciates a wholesome understanding of the concept to include economic, political and socio-cultural perspectives of development.

Law and development is an interdisciplinary study of law and economic and social development that examines the relation between law and development and how to use law as an instrument to promote economic development, democracy and human rights.

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Trubek, D. M.(2012) "Law and Development 50 Years On" *International Encyclopedia of Social and Behavioral Sciences* (forthcoming) University of Wisconsin Legal Studies Research Paper No. 1212, p. 2.
 Jedidiah Kroncke asserts that "law and development is built upon the deeply ingrained notion that America is solely an exporter of legal knowledge and, further, that American lawyers and legal institutions can be the altruistic catalysts of positive legal development abroad. See Kroncke, J. (2012) "Law and Development as Anti-Comparative Law" *Vanderbilt Journal of Transnational Law* Vol. 45:477-555, p. 479.

The law and development movement¹⁷² developed from several components. They included the idea of progress; the movement for law reform; the emergence of an interest in "law and society" and its various components;¹⁷³ and the notion of social engineering through law.¹⁷⁴

In the law and development context, "development" is a euphemism for progress. The work of law and development is therefore to lead the way to progress through law reform. Progress envisages the possibility of achieving a better society and specific measures for attaining it should be proposed.¹⁷⁵

In the 20th century governments, international institutions and aid agencies started and supported legal reform projects in a view to aiding developing countries. In the early stages of the movement, the dominant view was that a strong state was necessary for development. This was the way through which society could be transformed. Wrong kinds of legal rules and practices would have a negative impact on development. Later developments shifted emphasis from a strong state to the role of law in providing a framework within which non-state actors would operate through restraining excessive state intervention.¹⁷⁶

From a law and development perspective, three kinds of law reform can be identified. "Tinkering" accepts the existing system, seeks to keep it operating, and makes occasional adjustments to improve efficiency. "Following" refers to the sort of law reform intended to adjust the legal system to social change. "Leading" law reform, on the contrary, uses law to change society. Whereas law reform is a mixture

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¹⁷² In this study, we have steered clear of the twin debates of whether there has been one or several law and development movements (or waves or moments) and the conceptual debate of 'law and development' versus 'law in development' as they are outside the scope of this research.

These components include the sociology of law, anthropology of law, law and economics, law and psychology, and law and politics.

¹⁷⁴Merryman, J. H. "Comparative Law and Social Change: On the origins, Style, Decline and Revival of the Law and Development Movement", (1977) *The American Journal of Comparative Law* 457-491, p. 461.

¹⁷⁵*Ibid*, pp. 462-463.

¹⁷⁶Trubek, D. M. (2012) *supra*, p. 3.

¹⁷⁷ An example usually given is that of providing more judges when the judicial backlog seems unmanageable.

of all the three kinds, emphasis is usually placed on leading law reform if law is to be seen as an instrument of development and not merely a response to it. 178

Social engineering through law, or sociological jurisprudence, fills the gap left by the decline of natural law. It provides a guide to the right content and right administration of the law. A law should be administered, interpreted and applied in such a way as to advance the social objectives it expresses or implies. A proposed statute that advances a minor social interest at the expense of a major one should not be enacted. It is therefore important that when considering legislation for county tax administration, the major social objective of such a tax is important. 179

According to Max Weber, law is just a subclass of legitimate or normative orders. These orders are socially structured systems containing bodies of normative propositions that to a certain degree are subjectively accepted by the society as binding for their own sake. This is not necessarily so especially in light of the Constitution of Kenya, 2010, that redefines law to include a system of rules, principles, values and policies. 180

The gap between law and society's acceptance of changes can be overcome by evolving bureaucratic, administrative, legal and other techniques in order to secure compliance. If this fails, fresh techniques can be devised to close the gap. Law and development is particularly concerned with regulating social behaviour to secure its compliance consistent with the overall plans of society. 181

It has been observed that of all the development fields, law is the one that is most limited and confined by the fact that law is nation-or society-specific. Attempts to transcend the problem through comparative legal science bears little or no success. This has to a certain extent changed since Merryman made his observation as

¹⁷⁹*Ibid*, p. 465.

¹⁷⁸Merryman, J. H. (1977) *supra*, pp. 462-463.

¹⁸⁰ Trubek, D. M. "Max Weber on Law and the Rise of Capitalism", (1972) Yale Law School Faculty Scholarship Series Paper 4001, p. 726.

¹⁸¹Dhavan, R. "Law as Concern: Reflecting on Law and Development," in Vyas, Y. et al (eds)(1994) Law and Development in the Third World (Vol. 1), p. 32.

international law has come to be considered as part of national laws. However, tax law has not changed in any substantial way as it is largely local and statutory. 182

The relationship between law and development has been somewhat problematic. Law has been said to have either a positive or negative correlation to development or it has a neutral relationship with development. For the purposes of this study, we are emphasizing the positive correlation where law is expected to lead to positive development.

The law and development model suffers from certain unavoidable factors, due to the fact that lawyers from foreign jurisdictions take a lead in many of the projects. The natural intimacy between law and politics, the risks of cross-cultural formalism and the fallacy of implicit or idealized comparison play a role in the success or otherwise of the projects. It has, however, been observed that law and development is resilient and manages to evolve under new legal ideals such as human rights, sustainable development and legal internationalism.

There has been criticism of the law and development movement from various fronts. There are difficulties in external actors understanding how legal systems in developing countries work or come up with workable reform strategies. There has also been conflicts between the several ideas, for instance, the push for a strong developmental state on the one hand and a move towards deregulation on the other hand; and the law as an instrument of change on the one hand and the law as a neutral framework on the other.¹⁸⁵

Whereas the law and development movement ought to rely on empirical evidence on the role of law in developing countries, little has been done on this front. There is

¹⁸²Merryman, J. H. (1977) *supra*, p. 479.

¹⁸³ This leads to the foundational critiques based on instrumentalism, formalism, and idealization. Critiques of instrumentalism dismiss the notion of separating legal reform works from politics whereas critiques of formalism deal with the idea that foreign legal models can be transplanted seamlessly. The fallacy of idealization therefore is t the effect that there is a known legal ideal to be transferred from the donor jurisdiction to the done.

¹⁸⁴ Kroncke, J. (2012) *supra*, pp. 483-484.

¹⁸⁵ Trubek, D. M. (2012) *supra*, p. 4.

therefore a deficiency in diagnostic tools and measurement of reform results. Consequently, the policies proposed and implemented are not evidence based. 186

The law and development movement has been accused of not being able to learn from its history. It therefore continues to repeat the same mistakes. Indeed it has been considered not as a critical field of inquiry and action but only as a form of American cultural identity politics.¹⁸⁷ However, even with its track record of failure, law and development efforts still remain popular.¹⁸⁸

The devolved system of government has been connected to development and poverty reduction. The transfer of authority, power and responsibility to the counties is considered as a measure to involve the citizenry in policy-making and as such making development policies more responsive to the needs of the society.¹⁸⁹

Greater revenue autonomy and sustainable revenue sources at subnational level would lead to greater accountability and improved provision of services and infrastructure. As a consequence, this would promote economic development and local democracy. The end result would be an improved standard of living. Accordingly, it is important to craft laws in a manner that would lead to this eventuality. 190

To attain sustainable levels of development through tax administration, the reform measures should be formulated in tandem with the main rules of reform discussed in Chapter 1. The principal ones are the rule of results, the rule of relevance and the rule of robustness. Efforts should, however, be made to ensure that to the greatest extent possible, autochthonous reform measures are undertaken to avoid falling into the problems associated with cross-cultural formalism and unsustainable idealization.

¹⁸⁶ *Ibid*, p. 7. See also Kroncke, J. (2012) supra, p. 485, on more about this proposition.

¹⁸⁷ Kroncke, J. (2012) *supra*, p. 480.

¹⁸⁸ *Ibid*, p. 485.

¹⁸⁹ See Part 2.2 hereinabove.

¹⁹⁰ Monkam, N. F. (2010) *Mobilising Tax Revenue to Finance Development: The Case for Property Taxation in Francophone Africa*, Working Paper 195 (November), University of Pretoria, p.1.

2.4 THEORETICAL FRAMEWORK

Whereas this research transcends various theories, the dominant theory in this work is the Economic Analysis of Law theory. This theory is used here to provide for means through which tax administration can be conducted efficiently. Theories of economic development are also discussed along therewith as an undercurrent.

2.4.1 Economic Analysis of Law

Economic analysis of law is credited to Richard Posner, moreso his writings after 1970. His writings in the 1960s upto 1971 are considered to have been within the law and economics movement. The law and economics discourse involved the study of the influence of the legal system on the working of the economic system while economic analysis of law involves an economic analysis of the working of the legal system.¹⁹¹

The theory of economic analysis of law attempts to explain and predict the behaviour of participants in and persons regulated by the law. It also attempts to improve the law by pointing out respects in which laws have unintended or undesirable consequences on economic efficiency, the distribution of income and wealth, or other values. It has both positive (descriptive) and normative aspects. Some scholars consider it to have three different approaches; the predictive analysis, the functional interpretation and the normative analysis.

The predictive analysis looks at the likely consequences of a particular legal rule while the functional interpretation is interested in why a particular legal arrangement

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¹⁹¹ See Harnay, S. and A. Marciano (2008) "Posner, Economics and the Law: From Law and Economics to an Economic Analysis of Law" generally. It has been argued by Richard Wagner that 'law and economics' and 'economic analysis of law' deal with the same object, legal phenomena and matters, albeit through different conceptual lenses or 'windows' (See Marciano, A. (2006) "Value and Exchange in Law and Economics: Buchanan versus Posner" International Centre for Economic Research Working Paper Series, Working Paper No. 31/2006, p. 2).

¹⁹² Posner, R. A. (1998) *Values and Consequences: An Introduction to Economic Analysis of Law*, University of Chicago Law School Program in Law and Economics Working Paper 53, p. 2.

¹⁹³ Backhaus, J. G. (2001) *Economic Principles of Constitutions: An Economic Analysis of Constitutional Law*, Independent Institute Working Paper No. 40, "Introduction".

has taken the form it has. The normative analysis involves the norms embodied in legal rules, whether by uncovering the relationship between the particular norms or showing the extent to which there are trade-offs between particular norms. 194

The use of economic analysis of law is to make law simpler to understand and evaluate and to press for the defence of values. 195 It "applies the tools of microeconomic theory to the analysis of legal rules and institutions." ¹⁹⁶ All human behaviour or any kind of legal problem is capable of investigation using economic tools and analysis by economic theory. 197 Economics provides the law 'with tools to make decisions and understand the very functioning of the legal system'. 198 In the law and economics movement, two paradigms on the conception of economics: the exchange paradigm propounded by James Buchanan (based on the subject matter) and the value paradigm by Richard Posner (based on the methodology). The definition by Buchanan is narrower than Posner's as Posner defines economics as a set of tools. 199

Economic analysis of the law has been controversial mainly on its philosophical foundations. The debate has been on the four claims made as the basis of the theory. The first two made by Posner were "that common law legal rules are, in fact, efficient and that legal rules ought to be efficient." Kornhauser subsequently made two other claims to the effect that legal processes select for efficient rules and that individuals respond to legal rules economically, and he identified the last behavioural claim as central. The main controversy however has been whether economic analysis of law provides a comprehensive theory of law that challenges traditional approaches to law. 200 This thesis admits that the theory is a useful analytical tool in an attempt to understanding the political economy due to its multidisciplinary nature.

¹⁹⁴*Ibid*.

¹⁹⁵ Posner, R. A. (1998) *supra*, p. 1.

¹⁹⁶ Kornhauser, L. (2014) "The Economic Analysis of Law"; Edward N. Zalta (ed) *The Stanford Encyclopedia* of Philosophy, available at http://plato.stanford.edu/archives/spr2014/entries/legal-econanalysis accessed on

¹⁹⁷ Harnay, S. and A. Marciano (2008) *supra*, p. 10; and, Marciano, A. (2006) "Value and Exchange in Law and Economics: Buchanan versus Posner" International Centre for Economic Research Working Paper Series, Working Paper No. 31/2006, p. 14.

¹⁹⁸ Marciano, A. (2006) *ibid*, p. 15.

¹⁹⁹ Marciano, A. (2006) supra,p. 3 and generally.

²⁰⁰ Kornhauser, L. (2014) supra.

Kornhauser identifies two strands of thought within economic analysis of law, that is, policy analysis and political economy. Policy analysis focuses on the analysis of the effects of legal rules and institutions on outcomes; it assumes that public officials are conscientious; it adopts a welfarist stance towards evaluation of legal rules; and tends to proceed legal rule by legal rule. Political economy on the other hand investigates the operation of political institutions; assumes that public officials have the same motivation as private individuals of self-interest; it evolved from a contractarian tradition; and political economists generally hold that because legal rules are not promulgated by a single individual with power to control unilaterally the content of the rule then no purpose can be attributed to the promulgator of the legal rule. In this study, both strands of thought are relevant.²⁰¹

In its understanding of the concept of law, the policy analysis strand, in a manner, adopts some variant of legal positivism. The analysis of the behavioural effects of a legal rule begins with the assumption that the legal rule is clearly known and that public officials conscientiously apply the rule that ought to govern the event.²⁰²

Economic analysis of law makes attempts to improve law by identifying instances in which existing or proposed laws have unintended or undesirable consequences on economic efficiency, distribution of income and wealth, or other values. Economic analysis mainly consists of an endeavour to trace the consequences of assuming that people are more or less rational in their social interactions. Accordingly, the assumption that taxpayers and tax collectors are more or less rational should form the basis for ensuring that there are mechanisms to ensure compliance and reduce discretion. ²⁰³

County taxes in Kenya are the subject of constitutional provisions and not just legislation. This requires an analysis of constitutional provisions. The economic analysis of constitutional issues is complicated because the constitution itself determines the scope of the legal issues that are the subject of economic analysis.

²⁰¹ *Ibid*.

²⁰² *Ibid*.

²⁰³ Posner, R. A. (1998) *supra*, pp. 2-3.

However, constitutional norms are still within the scope of economic analysis. Accordingly, it is in order for us to assess the economic viability of the systems of taxation provided for under the constitution. ²⁰⁴

According to Posner, an economic analysis of the constitution addresses certain core topics. These include the economic properties and likely consequences of requiring a supermajority for some kind of political change (economic theory of constitutionalism); the economics of constitutional design; the economic effects of specific constitutional doctrines; the interpretation of constitutional provisions or doctrines that may have an implicit economic logic; proposals to refashion constitutional law to make it a comprehensive protection of free markets; the problem of dualism whereby courts may be committed to personal liberty but are indifferent to liberty in the economic sphere; any relationship between the Constitution and economic growth; and the relationship between economics and constitutional interpretation.²⁰⁵

In a country where there is a national government and subnational governments, the question of efficiency of sharing governmental powers among competing institutions arise. There is competition to provide good service at low cost or low tax. Those that do not succeed in lowering cost may lose residents or business enterprises to the more successful ones.²⁰⁶

Not every provision of a constitution is efficiency enhancing. The provisions that are not efficiency enhancing do not have any persuasive economic justification.²⁰⁷

In tax matters, it is important to reduce the role of courts as courts have limited competence to make economic decisions. The problem is exacerbated when constitutional doctrines are not self-defining or self-enforcing. Constitutional provisions should therefore set "broader outer bounds to the exercise of judicial discretion". Since a judge is guided by the spirit and letter of the Constitution,

²⁰⁴ Backhaus, j. g. (2001) *supra*.

²⁰⁵ Posner, R. A. (1987) *supra*, pp. 4-5.

²⁰⁶ *Ibid*, p. 14.

²⁰⁷ *Ibid*, p. 15.

economics help in identifying the consequences of alternative interpretations of the Constitution.²⁰⁸

Macey takes the position that an economic approach to constitutional analysis is the right approach. According to him, this approach is more sophisticated and rigorous in its use of models than the approach taken by Marxists. He is however of the view that the theories are identical at the core as both view the Constitution as a forum for the expression of a political equilibrium among competing, powerful special interest groups.²⁰⁹

The application of the theory of economic analysis of law in an attempt to solve problems in tax administration in Kenya especially in respect of county taxes is important because it avails economic tools to be used in the formulation and implementation of the requisite laws. Concepts such as tax gap, tax assignment and canons of taxation become relevant in law reform.

2.4.3 Theories of Economic Development

Three theories of economic development are relevant to this study.

The False Paradigm Model of the International-dependence revolution approach attributes underdevelopment to faulty and inappropriate advice provided by wellmeaning but often uninformed, biased and ethnocentric international "expert" advisers from developed-country assistance agencies and multinational donor organizations.²¹⁰ In certain instances, such advice leads to outright negative results.²¹¹ The perspectives used are usually those of people who have lived in developed countries or are educated there leading to the efforts of the aid agencies serving the interests of the elite and not the ordinary citizens of developing

²⁰⁸ *Ibid*, pp. 4 and 24.

²⁰⁹ Macey, J. R. (1987) "Competing Economic Views of the Constitution" 56 George Washington Law Review pp. 50-80, at pp. 51-52. ²¹⁰Todaro, M. P. (1994) *Economic Development* (7th edition), Longman, London, p. 92.

²¹¹ Cheeseman, N. & R. Griffiths (2005) "Increasing tax revenue in sub-Saharan Africa: The case of Kenya" OCGG Economy Analysis No. 6, Oxford Council on Good Governance, pp. 2-3.

countries.²¹² As seen in this research, the UK's Department for International Development (DFID), the World Bank and the IMF have been the key drivers of tax reforms in Kenya. By their very nature, reforms initiated and falling under this model are clearly in breach of the rule of results in the reform discourse as they rely on some predetermined standard. As observed earlier, legal reform ideas borrowed from foreign jurisdictions are bound to face serious obstacles that eventually determine their impact.²¹³

The criticism against the False Paradigm Model is mainly that it emphasizes the removal of international and domestic imbalances as the most effective way to deal with the diverse social problems and accelerate the pace of economic growth. It offers little formal or informal explanation on how countries initiate and sustain development. It also has little to show in terms of success especially when we look at less developed countries that have pursued mechanisms such as industrial nationalization and state-run production.

The Neoclassical Counterrevolution Approach has, as its central argument, that underdevelopment results from poor resource allocation due to incorrect pricing policies and too much state intervention by overly active developing world governments. It advocates freer markets and the dismantling of public ownership, central planning by the state and government regulation of economic activity. 214 The accusation of too much state intervention has been made against the Kenyan tax administration, especially on the application of the Electronic Tax Register (ETR).

There is criticism of the Neoclassical Counterrevolution Approach on the basis of its assumption that markets alone are efficient, technology is freely available and information is perfect. This is not the case in developing countries. Governments play a key role in facilitating operation of markets. Where government intervention doesn't produce the desired results, it may be because of corruption and mis-

²¹² Weller, C. (2012) "Neocolonial dependence model and the false paradigm: useful for explaining development in Haiti and the Dominican Republic?" Indian Journal of Economics and Business, March1, 2012,

p. 2. ²¹³ See Part 2.3 hereinabove. ²¹⁴ Todaro, M. P. (1994) *supra*, p. 95.

allocation of resources due to self-interest actions by politicians, bureaucrats or citizens.

The Underdevelopment Theory posits that capitalism is unlikely capable of providing the masses of the developing world with basic necessities and decencies of life in any foreseeable future. The capitalist developed world under-develops the developing countries through simple plunder and extortion; trade on unequal terms; promoting technological dependency; and, the supply of 'technical assistance' and especially economic advice by capitalist governments. This theory blames outsiders without necessarily interrogating internal weaknesses.²¹⁵

These theories are used here to supplement the law and development discourse and the theory of economic analysis of law. It is noteworthy that whereas development has various facets, economic development is still used as the major indicator of development.

As noted earlier, economic development is still the dominant perspective of development. This relates well with the main purpose of taxation, that of raising government revenue. A tax administration for the counties in Kenya should be capable of raising revenue for the sustenance and development of the county.

2.5 CONCLUSION

The need for a strategy for the sustainable administration of county taxes in Kenya has a constitutional basis. The fiscal sustainability of counties would go a long way towards the sustainability of the devolved system of governance itself.

The use of concepts such as tax gap is important as a measurement for the success of a tax administration. However, for purposes of subnational taxes, it is necessary to assess the nature of the taxes with a view to coming up with a sustainable approach.

University of California Press, Berkeley & Los Angeles, pp. 8-20.

²¹⁵ Leys, C. (1975) Underdevelopment in Kenya: The Political Economy of Neocolonialism, 1964-1971,

The tax/GDP ratio may not be a suitable test as, among other reasons, it is not easy to measure the GDP of a county as the economy is fluid across county boundaries.

Reforms in tax administration are geared towards promotion of efficiency and fairness. This study takes efficiency in tax administration to mean the ability to collect taxes at the least effort, expending the least resources in terms of time and finances, and raising the optimum revenue. This should be undertaken in a manner that brings equity to the taxpayers and affording them reasonable opportunities to resolve any disputes arising.

The law and development discourse propounds a position whereby law influences positive development. As such, a tax administration for the counties in Kenya should be geared towards promoting development. The use of economic tools and the analysis of the efficiency and cost implications for the system is necessary and hence the theory of economic analysis of law. Because of the dominant role that economics play in development, theories of economic development add relevance to the composite strategy.

In the following Chapter we discuss taxpayer identification and registration as a tax administration tool.

CHAPTER 3

TAXPAYER IDENTIFICATION AND REGISTRATION AS A TAX ADMINISTRATION TOOL

This chapter addresses the first research question on whether the PIN used at the national level by KRA is suitable for the administration of county taxes in Kenya. It therefore attempts to fulfil the first specific research objective 'to analyse and study the concept of taxpayer identification and registration in Kenya with a view to assessing its efficacy and whether it is suitable for the administration of county taxes'. Part of this objective is further addressed in Chapter 5.

3.1 RATIONALE FOR TAXPAYER IDENTIFICATION AND REGISTRATION

Almost all tax systems use a Taxpayer Identification Number (TIN) in some form to track taxpayers.²¹⁶ This number goes by other names such as the Personal Identification Number (PIN)²¹⁷ and the Individual Taxpayer Number (ITN).²¹⁸ It is a form of tax control.²¹⁹ The use of a number is necessitated by the number of taxpayers involved.

It has been observed that a good tax administration requires a reliable single centrally–maintained register of taxpayers. Such a register should contain only the relevant particulars such as name, address and the nature of business or activity of the taxpayer. The taxpayer should then be given a unique number. ²²⁰

²¹⁶Bird, R. M. and E. M Zolt (2008) "Technology and taxation in Developing Countries: From Hand to Mouse", p. 15 (available at http://ssrn.com/abstract=1086853, accessed on May 29, 2013).

²¹⁷This is the version used in Kenya.

²¹⁸Burnysheva, L. V. (n.d) "State Registration and Account of Taxpayers as a form of Prior Tax Control", p. 14. ITN is the version used in Russia, though in Russian it becomes INN.

²¹⁹*Ibid*, p. 12.

²²⁰Bird, R. M. and E. M. Zolt (2008) supra, p.15.

PINs are either issued by the tax department or authority like in Kenya²²¹ or by other government agencies, like in China and the former Soviet Union.²²² Each of these has its own shortcomings either as a result of lack of controls or on the other extreme, strict controls.

It should be ensured that no number is assigned to more than one taxpayer, or that no taxpayer has more than one number. There should also be means to ensure that all registrable taxpayers are registered. Some scholars also identify the problem of over-registration and propose that there should be a reasonable registration threshold. However, it is the view of this study that the concept of taxpayer identification over-registration is a misnomer as there should be the intention to register as many taxpayers as possible. This will not only aid in the actual tax collection but also in the creation of a database to aid in an audit trail for purposes of measuring compliance. 223

The taxpayer identification number has had a controversial history. Some Christian theologians opine that this is the number or mark of the beast mentioned in the Holy Bible.²²⁴ However, tax authorities have largely been indifferent to this view.²²⁵

Personal identification systems have been seen as contradictory to the fundamental principles of personal liberty.²²⁶ The argument is that such a system raises ethical

²²¹The Kenya Revenue Authority (KRA) issues the PIN, which was previously issued by the Income Tax Department prior to the establishment of the KRA.

²²²Silvani, C. and Baer, K. (1997) *supra*, p. 18.

²²⁴ This is variously referred to in Revelation 13:17, 14:9, 14:11, 15:2, 16:2, 19:20 and 20:4. The Bible warns against receiving this mark.

²²⁵ I do not intend to pursue this line of argument for two reasons: one, it is not possible to scientifically test religious concerns for purposes of scholarly research, and secondly, either way would not have a different impact on the course of this research.

²²⁶ The term liberty here can be conceptualised in the John Stuart Mill way as the protection against the tyranny of political rulers. The question therefore arises as to whether the authority to levy taxes would be regarded as necessary. The general view is that it is necessary. Since we live in a society, everyone who receives the protection of society owes a return for the benefit. The fact of living in a society renders it indispensable that

and public policy concerns for a free society. This is because they transform 'individuals' identities from the inherent qualities of persons who have and deserve dignity and general protection under the constitution to attributes represented by numbers, cards and places in databanks [and] the process degrades the moral value of political and personal identity as an intrinsic quality of personhood". Therefore, under such a system, identity is attained through numbers and cards and such pseudo identities become commodities in a political economy of surveillance which in turn undermines the nature of personhood, identity and privacy in a free society. 228

Both Richard Sobel and Robert Ellis Smith note that a national identification system (NIDS) is more relevant in an authoritarian society than a democratic society. This is because in an open democratic society, the government derives state power from the people and the constitution, and which must be exercised in ways respectful of privacy. In contrast, authoritarian societies intrude into individuals' lives by bestowing or denying identities and opportunities through identification numbers or documents.²²⁹

When identification documents are used for accessing various government services, the issue becomes deeper. When the exercise of fundamental rights is only possible when one has proper documentation, the nature of political and personal identity and dignity are degraded. This applies when the taxpayer identification number is required to access public services or vie for political offices. The identification number usage has been extended to many non-core tax activities, including opening of private bank accounts. ²³⁰

each person should be bound to observe a certain code of conduct towards the rest. The society is justified to enforce conduct.

²²⁷Sobel, R. (2002) "The Degradation of Political Identity under a National Identification System", p. 2. The article was published in the Boston University Journal of Science & Technology Law and was accessed at www.bu.edu/law/central/jd/organizations/journals/scitech/volume81/sobel.pdf on May 29,2013.

²²⁸*Ibid*.

²²⁹*Ibid*, p. 3.

²³⁰*Ibid*, p. 4.

In the 1970s, Justice Douglas of the US Supreme Court in his concurrence in $Roe\ v$. $Wade^{231}$ and his dissent in $United\ States\ v$. $White^{232}$ was emphatic on the importance of personhood. 233

Any form of identification and registration would inevitably bring the questions of privacy and the use of the data held by the state agencies. Indeed, Nazi Germany used a registration and census process to identify the Jews in preparation for their extermination.²³⁴ Confidentiality of the data held is also a major concern.²³⁵

Whereas Sobel argues against a national identification system, it is the submission of this thesis that for efficient and effective tax administration, there is need for taxpayer identification and registration. The right to privacy has to be tampered with due to the need to efficiently organize public affairs.

The Constitution of Kenya provides for the right to privacy, which includes the right not to have a person, his home or property searched; his possessions seized; information relating to his family or private affairs unnecessarily required or revealed; or the privacy of his communications infringed.²³⁶ It is noteworthy that the right to privacy is not one of the rights and freedoms listed under Article 25 which cannot be limited. Further, in terms of Article 24, the right to privacy can be limited within reasonable and justifiable limits as would be expected in an open and democratic

²³¹410 US 179 (1973). He said that "the autonomous control over the development and expression of one's intellect, interests, tastes and personality" is a constitutionally protected right and fundamental to privacy (at 211).

²³²401 US 745(1971). At 764, he said: "Invasions of privacy demean the individual. Can a society be better than the people composing it? When a government degrades its citizens, or permits them to degrade each other, however beneficent the specific purpose, it limits opportunities for individual fulfilment and national accomplishment."

²³³Sobel, R. (2002) *supra*, p.15.

 $^{^{234}}Ibid$, pp. 13 - 15.

²³⁵For instance, in the 1930s, US president Roosevelt and Congress promised that the social security number would be kept confidential and would not be used for purposes of identification. In several instances, government offices have been caught using it for unintended purposes. This number has been extended to be used as the taxpayer identification number. See Sobel, R.(2002) *supra*, generally.

²³⁶ Article 31, Constitution of Kenya, 2010.

society on the basis of human dignity, equality and freedom. The factors that would be taken into consideration in such an endeavour are the nature of the right or fundamental freedom; the importance of the purpose of the limitation; the nature and extent of the limitation; the need to ensure that the enjoyment of rights and fundamental freedoms by any individual does not prejudice the rights and fundamental freedoms of others; and, the relation between the limitation and its purpose and whether there are less restrictive means to achieve the purpose.

The extent of registration of taxpayers brings the issue of over–registration and under-registration. Some authors identify the concept of over-registration of taxpayers which makes it more difficult to identify and monitor taxpayers. This is because it adds an unproductive workload to the tax administration. They therefore suggest the need for the setting of a threshold.²³⁷ However, this thesis takes the considered view that there would never be over-registration. This is because all taxpayers should be identified and registered. Further, even those who have no tax to pay should be registered so as to develop a mechanism to check the veracity of returns filed by the taxpayers when they file their returns.

Unregistered taxpayers may be detected by auditing registered taxpayers with a view to detecting their unregistered suppliers or customers and by conducting searches or inspections. Door-to-door inspections may also be undertaken, especially with a view to vetting taxpayers in the informal economy. ²³⁸

Several jurisdictions now use improved technology for tax administration. As such the taxpayer identification number is used by the system for purposes of storing and accessing data. Some even link the system to other government activities or even issue "smart" cards to citizens that contain both the PIN and other information. This

²³⁷See Silvani, C. and Baer, K. (1997) *supra*, p.18.

²³⁸*Ibid*.

would make it difficult for an unregistered person to access government services²³⁹ and as such ensure compliance.²⁴⁰

To achieve good revenue administration there is need for a robust system of taxpayer identification. This should depend on the needs of the tax administration.²⁴¹ The system should have sufficient safeguards to ensure its integrity. No PIN should, for instance, be assigned to more than one taxpayer and no taxpayer should have more than one PIN.²⁴²

The implementation of a taxpayer identification and registration system should consider the special circumstances obtaining in the particular jurisdiction. It is important to assess the applicability of such a system in a largely informal economy as compared to a formal economy. This will help in alleviating the negative impact associated with tax culture shock and lag.

3.2 THE MECHANICS OF PIN IN KENYA

3.2.1 The Historical Background

At the Berlin Conference that partitioned Africa, the area now known as Kenya was handed over to the British. Initially it was run by the Imperial British East Africa Company (IBEA) on behalf of the British government as from 1887. It then became the East African Protectorate in 1895 before being declared the Kenya Colony in 1920 thereby setting the ground for direct British rule.

The Native Hut and Poll Tax Ordinance 1910, conferred upon the Governor the power to make rules for the proper administration of the Hut and Poll Taxes.²⁴³ Vide

²³⁹This may include the purchase and transfer of property and use of public facilities. Some private enterprises may also require registration. For instance, banks and insurance companies may require the number to access their services.

²⁴⁰Bird, R. M. and E. M. Zolt (2008) *supra*, p. 15.

²⁴¹Kloden, D. (2011) *supra*, p. 30.

²⁴²Silvani, C. and Baer, K. (1997) *supra*, pp. 17 – 18.

²⁴³Section 9. The Native Hut and Poll Tax Ordinance, 1910.

Government Notice No. 19 dated 25th January 1913;²⁴⁴ Governor H.C. Belfield issued the Collection of Taxes and the Duties of Hut Counters and Headmen Rules. These rules placed the colonial administrators at the centre of tax administration.

District officers were required to prepare a complete roll of taxpayers in their respective districts every year. ²⁴⁵ The contents of the tax roll were the name of every owner of a hut, the number of huts owned by each hut owner and the number of wives of each hut owner. ²⁴⁶ In the districts where the Poll Tax was leviable, the name and fathers' name of native liable to pay Poll Tax was also required to be put in the roll. ²⁴⁷

In the preparation of the tax roll, the District Officer was assisted by Hut-counters. The Headman was enjoined to assist the Hut-counter by furnishing him with any information that he required, and indeed to accompany the Hut-counter except where he was excused by the District Officer. After the registration process, the District Officer would then notify the Headman of the date and venue where he would attend to receive the taxes payable, who would in turn ensure that the taxpayers would attend or otherwise pay tax due. 251

The Hut and Poll Taxes served two purposes: they raised revenue and forced a proportion of the African population into wage labour. The movement of labour was further regulated and controlled through the *kipande* system.²⁵² The cheap labour was needed for the emerging economy.²⁵³

²⁴⁴Kenya Gazette (Official Gazette, as it was then known) of 1st February 1913.

²⁴⁵Rule 2.

²⁴⁶Rule 2(a).

²⁴⁷Rule 2(b).

²⁴⁸Rule 3.

²⁴⁹The term 'Headman' meant a person appointed as such under the Native Authority Ordinance, 1912, to be in charge of an area, in most instances, a village. In certain instances, a Council of Elders was appointed to be in charge of an area, and as such would act as the collective Headman.

²⁵⁰Rule 4.

²⁵¹Rule 5.

²⁵²Swainson, N. (1980) *The Development of Corporate Capitalism in Kenya, 1918 – 77*, University of California Press, Berkeley and Los Angeles, p. 32.

Due to the view that colonial authorities had of Africans primarily as providers of labour for European farms, various ordinances were passed towards this end. These included the East African Hut Tax Ordinance, 1903, the Native Hut Tax and Poll Tax Ordinance, 1910, the Village Headmen Ordinance, 1907, the Native Authority Ordinance, 1907 and the Native Registration Ordinance. 1921.²⁵⁴

The colonial government first levied a two – rupee Hut Tax²⁵⁵ on all homesteads with a view to forcing the locals to become labourers. In 1910, the Hut Tax was supplemented by a Poll Tax on all males above the apparent age of 16 years. In 1921 the Native Registration Ordinance was passed requiring all males over 16 years of apparent age to register at the district office and to bear an identification card with fingerprints around their necks (kipande) and a record of employment. The local administrators or headmen were tasked to oversee the collection of taxes.²⁵⁶ This was a mark of the authoritarian system of the time that had no regard for respect of personhood and privacy.

The Native Registration Ordinance, 1915, provided for registration officers for the purpose of registering locals. Further, the Governor had power to appoint any other person to exercise the powers of a registration officer.²⁵⁷ For instance, in 1921, he appointed a Clerk in the Native Affairs Department to act as such registration officer.²⁵⁸

²⁵³ See Mulinge, M. M. & G. N. Lesetedi (1998) *supra*, pp. 18-19, for a discussion on how the introduction of these taxes fostered the growth of corruption that formed the foundation of the corrupt practices in Africa today. The collection of the taxes involved the African chiefs who were motivated to collect more by being allowed to retain part of it and leading to private accumulation of wealth.

²⁵⁴Okuro, S. O. "Land Reform in Kenya: The Place of Land Tribunals in Kombewa," in Macamo, E. S. (ed.) (2005) Negotiating Modernity: Africa's Ambivalent Experience, Zed Books, London and New York, p. 179.

²⁵⁵ Hut Tax was introduced in 1901 and every man was liable for taxes on the huts he owned.

²⁵⁶Whiting. B. et.al (2004) "The Historical Stage" in Edwards, C. P. and B. B. Whiting (eds.) Ngecha: A Kenyan Village in a Time of Rapid Social Change, University of Nebraska Press, pp. 69-70. See also Mulinge, M. M. & G. N. Lesetedi (1998) supra, generally, on the role of administrators in the collection of these taxes.

²⁵⁷Section 2, Native Registration Ordinance, 1915.

²⁵⁸Government Notice No. 435 dated 17th November 1921 in the Kenya Gazette of 23rd November 1921.

The Native Registration Rules, 1919,²⁵⁹ provided for the certificate to be issued to a person upon registration.²⁶⁰ The forms used in the registration were then forwarded to the Central Registration Bureau in Nairobi.²⁶¹

The Rules also provided for the temporary registration of a native not in the reserve²⁶² set aside for his tribe. The native would have to exchange the temporary certificate with a permanent certificate upon return to the reserve set aside for his tribe.²⁶³

The Native Registration Ordinance, though enacted in 1915, was only put into effect in November 1919, due to shortage of administrative staff. It became the key to the legislation providing a labour supply and it is through it that labour contracts were enforced. Shortage of staff for tax administration is an old issue and therefore efficient means of administration are necessary that would reduce the heavy reliance on personnel numbers.

The Hut Tax and Poll Tax formed the basis which future taxes would be imposed in what later became Kenya. Indeed, the two, together with the registration process under the Native Registration Ordinance, provides the real historical background of taxation system in Kenya.

Throughout the colonial era, the government made several attempts in reforming the tax system. In each of the instances when the government intended to introduce reforms in the system, it would set up commissions that would come up with reports, which usually preceded the enactment of legislation. These include the Moyne

²⁵⁹Made under the Native Registration Ordinance, 1915, and published as Government Notice No. 374 dated 1st November 1919 in the Kenya Gazette of 5th November 1919.

²⁶⁰Rules 2 and 3.

²⁶¹Rule 4.

²⁶²A reserve was the geographical area within which the colonial administration restricted members of a particular tribe.

²⁶³Rule 7.

Report,²⁶⁵ the Pim Report,²⁶⁶ the Merchant Report²⁶⁷, the Gill Report²⁶⁸ and the Coates Report.²⁶⁹ These from time to time brought changes in the manner and mode of identification and registration of taxpayers.

It is clear that during the colonial era, the purpose of taxation (and identification and registration of taxpayers) was more of a tool to force Africans to work for Europeans than a tax administration tool. This to a great extent, formed part of the reasons for the agitation for freedom. As such, it was not a voluntary process and it can be argued that this has affected the mindset of post–colonial Kenya taxpayers. The purpose of taxation in Kenya has shifted from a tool to ensure there is labour to one that is largely a revenue-raising tool. Accordingly, the system of identification and registration of taxpayers should be geared towards efficiency in tax collection thereby resulting in higher revenues.

3.2.2 Present Day PIN

PIN is imposed by Section 132(1) of the Income Tax Act²⁷⁰ which provides as follows:-

"Every person whose income is chargeable to tax under this Act shall have a personal identification number, which shall be produced when required under the rules prescribed by the Commissioner".

Subsection 2 extends this requirement to any person whom the Commissioner may require for the "purpose of collection or protection of tax". This in effect means that

²⁶⁵Report by the Financial Commissioner (Lord Moyne) on Certain Questions in Kenya, 1932, His Majesty's Stationery Office, London, 1932.

²⁶⁶ Report of the Commission appointed to Inquire into and Report on the Financial Position and Systems of Taxation of Kenya, 1936, His Majesty's Stationery Office, London, 1936.

²⁶⁷Report of the Committee of Inquiry into Graduated Personal Tax (GPT), 1950, Government Printer, Nairobi, 1950.

²⁶⁸The Report of the Income Tax Committee, Kenya, 1954, Government Printer, Nairobi, 1954.

²⁶⁹Report of the East African Commission of Inquiry on Income Tax, 1956-7, High Commission Printer, Nairobi, 1957.

²⁷⁰Chapter 470, Laws of Kenya.

even where a person is not chargeable to tax under the Income Tax Act, he may be required to obtain a PIN. The requirement of "purpose of collection or protection of tax" is wide enough to cover any possible reason for the Commissioner to do so.

These wide powers of the Commissioner apparently invade into the privacy of the citizens. For instance, the Commissioner can invoke the requirement to obtain a PIN for the purpose of 'protection' of tax against a person who is not necessarily a taxpayer.

The number is required to be included in the returns and any other statements made under the Act, and also forms part of the details needed in returns under other laws.²⁷¹ Indeed, in tax terms, persons in Kenya are PIN numbers, for this is required to legitimise a myriad of transactions.

Whereas the Act provides a default clause and penalty for failure to obtain the number, among other related offences, ²⁷² it also gives the Commissioner power to register and issue a PIN to a person who has failed to obtain the number. ²⁷³ This introduces the concept of compulsory registration.

Obtaining a PIN is clearly not voluntary. It is impossible to have dealings in the formal economy in Kenya today without one. All property–related transactions that require registration with the government require a PIN.²⁷⁴ The same applies to private transactions such as opening bank accounts whereby the Know Your Customer (KYC) Rules require banks to require the production of the PINs of their customers. Even university students applying for educational loans from the Higher Education Loans Board (HELB) are required to have PINs.²⁷⁵

²⁷³Section 132(8).

²⁷¹For instance, the returns made under the Value Added Tax Act, Chapter 471 Laws of Kenya, require the indication of the PIN, notwithstanding that every person chargeable under that Act has a VAT number.

²⁷²Section 132(7).

²⁷⁴ These include the registration of leases, charges and transfers involving land.

²⁷⁵ As will be seen later in this chapter, this led to the clogging of the system with "tax-unproductive" university students.

The Thirteenth Schedule to the Income Tax Act²⁷⁶ provides the transactions for which the PIN is required. They are:

- Registration of title and stamping of instruments by the Commissioner of Lands;
- b) Approval of plans and payment of water deposits by the local authorities: 277
- c) Registration of motor vehicles, transfer of motor vehicles and licensing of motor vehicles under the Traffic Act²⁷⁸ by the Registrar of Motor Vehicles;
- d) New registration of business names by the Registrar of Business Names;
- e) Incorporation of companies by the Registrar of Companies;
- f) Applying for registration with the Commissioner of VAT;
- g) Dealing with the Central Bank of Kenya;
- h) Importation of goods, customs clearing and forwarding, under the Customs and Excise Act;²⁷⁹
- i) Payment of deposit for power connection with the Kenya Power; and,
- j) All contracts and supply of goods and services to all government ministries and public bodies.

The effect of the foregoing is that in almost all dealings with public offices, a PIN would be required. This ensures forced compliance. Indeed, even dealings with private entities have, of necessity, come to embrace the requirement of the PIN. This influences behaviour and as such law becomes an instrument of development.

It has been documented that the uptake of the PIN is still low among small and micro enterprises in Kenya. For instance, in Kerugoya town, Kirinyaga County, research conducted indicated that only 53% of the respondents had a PIN.²⁸⁰

²⁷⁶Pursuant to Section 132(6).

²⁷⁷ Reference now should be made to water companies.

²⁷⁸Chapter 403, Laws of Kenya.

²⁷⁹Chapter 472, Laws of Kenya.

²⁸⁰ Lumumba, O. M., M. S. Wanjohi & O. Magutu (2010) "Taxpayers' Attitudes and Tax Compliance Behaviour in Kenya: How the Taxpayers' Attitudes Influence Compliance Behaviour among SMEs Business Income Earners in Kerugoya Town, Kirinyaga District," *African Journal of Business & Management*, Volume 1, 112-122, p.117.

KRA intends to increase the range of transactions for which a PIN would be required. This is geared towards increasing the potential for detection. This enhances the efficiency of the system. ²⁸¹

The Income Tax Act is both a substantive and administrative tax statute. Indeed the preamble includes the administration aspect as one of the purposes of the Act.

The Act provides for the application of information technology in the carrying out of formalities and procedures under the Act.²⁸² These would include registration of taxpayers and obtaining a PIN. Indeed application for a PIN is now done through the KRA website.²⁸³

It is noteworthy that on application for a PIN, the applicant is required to provide his national identification card number. For an incorporated company, the Certificate of Incorporation number is required. The same applies to other registered entities who are required to provide their registration numbers. Lately, KRA seeks data on applicants from the registering authority as a way of authenticating the data provided by the applicant.²⁸⁴

KRA intends to continue to leverage on third party information and supporting IT solutions.²⁸⁵ This means interfacing KRA systems to external systems such as the Integrated Population Registration System (IPRS), companies' registry, Ministry of Lands, Regional Intelligence Liaison Office (RILO) and other government agencies and private sector systems. This is for purposes of information exchange. It also intends to apply third party information from identified external sources and open

²⁸¹KRA (2012) *supra*, p. 87.

²⁸²Section 127A.

²⁸³www.kra.go.ke

²⁸⁴ In certain instances, this has caused a lag between the time a company, for instance, is registered by the registrar of companies and the time when the electronic data is submitted to KRA to enable online application for PIN.

²⁸⁵KRA (2012) *supra*, p. 63.

intelligence for taxpayer recruitment, data matching and risk profiling purposes, and to validate tax returns.²⁸⁶

Information exchange and use of third party information makes the application of the law economical. Indeed it leads to efficiency and as such works towards the realization of development goals.

3.3 DEVOLUTION OF TAXPAYER INFORMATION TO THE COUNTIES

The question relating to the sharing of taxpayer information between the national government and the counties is key to the administration. This determines whether counties undertake their own independent registration of taxpayers or they can have access to the national taxpayer register. The extent of access would also matter.

The access by subnational governments or counties to information on revenue and taxpayer accounts would be useful to the counties. This is because it can be used to forecast revenues or to simulate the revenue and distributional impact of changes in the structure of the tax. It would also be useful as a delinquency control tool.²⁸⁷

Whereas taxpayer information may be available to subnational governments in centralized tax administration systems, this is the exception rather than the rule. The failure to receive adequate information on taxpayer accounts from the national tax service is rife in many transitional and developing countries. In some countries, the failure to disclose by the national tax administrator is in compliance with legislation forbidding it whereas in others it is as a result of administrative and political decisions. Demands for sharing information are troublesome where some central government taxes are shared with subnational government but are easily satisfied where there are separate tax administrations.²⁸⁸ As noted earlier, under the Constitution of Kenya, 2010, there are separate and parallel tax administrations in Kenya.

²⁸⁶*Ibid*, p. 64.

²⁸⁷Martinez – Vazquez, J. and A. Timofeev (2005) *supra*, p. 12.

²⁸⁸*Ibid*, pp. 12–13.

The information held by KRA is not available for general use. Section 125(1) of the Income Tax Act²⁸⁹ provides thus:

"An officer and any other person employed in carrying out the provisions of this Act shall regard and deal with all documents and information relating to the income of a person and all confidential instructions in respect of the administration of the Income Tax Department which may come into his possession or to his knowledge in the course of his duties as secret."

Whereas subsections 2 and 3 provides for some exceptions, none can be construed to give a blanket authority to share data with another person or entity. Indeed section 126 of the Income Tax Act and section 14 of the Kenya Revenue Authority Act²⁹⁰ provide for the liability of the officers of KRA for offences, acts and omissions by them in the course of their duties.

It has been observed that being in control of the administration and enforcement of its own tax enables a subnational government to raise revenues at the margin. It has the opportunity to plan and make policy decisions. The extent of control depends on the structure of government and the authority given to the subnational units by the Constitution. ²⁹¹

In Australia, except for the state government services for property assessments at the local level, there is no provision for exchange of information across the levels of government or any other explicit form of co-operation among the different levels of tax administration. The different levels of tax administrations have to set up and run their own independent systems.²⁹²

In Brazil, although registration for VAT at state level is coordinated with federal income tax authorities, in general there is no coordination or administrative integration of any type between the federal tax administration and the state level.

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²⁸⁹ Chapter 470, Laws of Kenya.

²⁹⁰ Chapter 469, Laws of Kenya.

²⁹¹Martinez – Vazquez, J. and A. Timofeev (2005) *supra*, p. 13.

²⁹²*Ibid*, pp. 19-20.

Different legal norms and bookkeeping systems are used. Taxpayers have to employ two different taxpayer identification numbers.²⁹³

In the United States, federal state and local governments have their own separate tax administrations, but there is coordination and cooperation to a certain extent. In some cases, local governments themselves arrange for a 'consolidated' administration system. For instance, the Central Collection Agency (CCA), a part of the Cleveland (Ohio, USA) department of finance, administers the individual income taxes levied independently by forty-three Ohio municipalities. It performs all functions of a standard tax administration agency including maintaining the taxpayer list. ²⁹⁴

The federal Internal Revenue Service (IRS) and the independent state departments have information exchange agreements that provide states with return filing data, third party reports and IRS audit reports. This enables the horizontal reaping of information sharing benefits. ²⁹⁵ It should be noted that the taxes administered by state departments in the United States are substantially different from those administered by counties in Kenya. States in the United States have a wider range of taxes.

In countries whose tax administration exhibit features of centralized, separate or independent and decentralized tax administrations (mixed models), the relationship between the various levels either follows some rationale or is just a historical accident unique to a particular country's experience.²⁹⁶

In Canada, some sub-national taxes are under a centralized administration while others are separate. For some taxes, even the registration process is different between the provinces. The organization of tax administration in Spain is characterized by the lack of integration between the different taxation authorities of

²⁹⁴*Ibid*, pp. 21-22.

²⁹³*Ibid*, p. 20.

²⁹⁵Mikesell, J. L. (2003) *International Experiences with Administration of Local Taxes: A Review of Practices and Issues*, World Bank Thematic Group on Taxation and Tax Policy, World Bank, Washington DC, p. 41.

²⁹⁶Martinez – Vazquez, J. and A. Timofeev (2005) supra, p. 22.

different levels of government which also leads to a reduction in effectiveness of tax administration. There has also been lack of cooperation between the central and regional tax administrations, with the common complaint from the regions being the central administration's unwillingness to share taxpayer information with the regional authorities.²⁹⁷

In countries with fully decentralized tax authorities, the experience in information sharing is different. Germany is the only country that operates with a fully decentralized tax administration.²⁹⁸ Germany is divided into sixteen states (Lander).²⁹⁹ Tax policy is fully centralized while tax administration is performed by the states. The Landers have information-sharing agreements regarding business that pay taxes in more than one Lander. ³⁰⁰

In a multi-level tax administration system, cooperation and exchange of information, both horizontally and vertically, can improve administration and make compliance easier. The cooperation may include coordination of registration for national and subnational taxes and the use of a single taxpayer identification number to the greatest extent possible. ³⁰¹

As seen earlier, in Canada, provincial governments have formal arrangements among themselves for a regular exchange of information, though not every province has an agreement with every other province. In Japan, the National Tax Administration and local tax authorities collect and share information on taxpayers. In Estonia, the national tax service requires local governments to pass on some information. In Hungary, the local tax authority may request for information from the central tax administration. The central authorities provide local governments with the

²⁹⁷*Ibid*, pp. 24-26.

²⁹⁸*Ibid*, p. 28.

²⁹⁹These include the five new states of the former East Germany. The German Constitution divides authority among tiers of government along quite explicit lines. The central government is responsible for policy formulation and financing while lower levels of government are generally in charge of administering and implementing policies. (cf. Martinez – Vazquez, J. and A. Timofeev (2005) *supra*, p. 28)

³⁰⁰Martinez – Vazquez, J. and A. Timofeev (2005) *supra*, pp. 28-29.

³⁰¹*Ibid*, p. 35.

software needed for computer-based taxpayer registration, which allows a uniform system of registration across the administrations.³⁰²

Even where there are sub-national taxes, a centrally administered tax would typically include a unified registration process for taxpayers and taxpayer identification numbers that serve for all levels of government. An often cited apparent advantage of independent sub-national tax administration is that due to familiarity with local conditions and easy adaptability to those local conditions, it is easier to facilitate, among others, registration of taxpayers. ³⁰³

In the United States, the states are free to organize tax administration as they see fit. Taxpayer registration for state taxes is distinct from federal registration and some states require separate registration for each state tax though one-stop registration procedures and automatic registration for multiple taxes after completing a single questionnaire are widely used. Taxpayer identification numbers for business taxes may differ from numbers used for the federal system but individual income tax numbers are the same for state and federal taxes. 304

In Nigeria, the sub-national units face challenges such as lack of master lists for taxpayers. They can track companies through the national VAT registration but have no identification number system for individuals. The interaction between registration of liable taxpayers and correct assessment of tax liability of those taxpayers determines the effectiveness of the assessment. Taxpayer registration is facilitated by control mechanisms introduced by the revenue administration. The maintenance of a taxpayer database based on a unique taxpayer identification number is an important element of such a control system. The effectiveness would improve if it is combined with other government registration systems such as issue of

³⁰²*Ibid*, p. 36.

³⁰³Mikesell, J. L. (2003) *supra*, pp. 10 and 15.

³⁰⁴*Ibid*, pp. 39-40.

³⁰⁵*Ibid*, p. 43.

business licences, opening of bank accounts and pension fund accounts. Further, occasional surveys of potential taxpayers should be conducted. ³⁰⁶

For purposes of county tax administration in Kenya, lessons can be drawn from the information sharing and exchange arrangements in Canada, Germany and the United States. However, there would not be need to adopt the system in the United States of independent registration of taxpayers for the reasons to be adduced later. The Hungarian experience where the central tax administration provides the local tax administrations with computer-based taxpayer registration details access would also aid in county taxes administration.

3.4 PRIMARY RESEARCH FINDINGS

The methodology used in the research is described in Chapter 1. It included questionnaires filled by KRA officers, taxpayers and tax professionals. It also included an oral interview and a focus group discussion.

3.4.1 Findings from KRA Officers

Since the introduction of the PIN, KRA has registered increased revenue collection, though the respondents did not indicate figures. This is attributed to the fact that every taxpayer is uniquely identified by the PIN. For this to be achieved there was the rolling out of a programme of registering taxpayers which led to increased taxpayer registration. Thereafter, filing of returns was enhanced. It has also ensured that taxpayers report their tax obligations and pay taxes as they fall due. The use of the PIN therefore promoted increased compliance in the areas of taxpayer registration, filing of tax returns, reporting of tax liabilities and payment of taxes.

The use of the PIN widened the tax base leading to increased tax collections. In addition to identifying taxpayers, it helps in linking the sources of income and as such assist in the monitoring of taxpayers to ensure compliance.

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³⁰⁶PEFA Secretariat (2011) *Public Financial Management Performance Measurement Framework*, PEFA Secretariat, Washington DC, p. 30.

Some respondents listed registration in wrong tax obligations as a challenge experienced with the PIN. This initially supposedly gave an impression of increased tax potential only for audits to reveal substantial cases of people having registered in wrong tax obligations. However, as argued earlier in this Chapter, there cannot be over-registration and wrong registration as all taxpayers ought to obtain a PIN.

In an interview with a KRA officer³⁰⁷, it was said that the requirement for obtaining a PIN generally has in a manner clogged the KRA system. This has especially been felt in the requirement to have university students applying for HELB loans to have a PIN. This has led to a large number of persons being on the PIN system who are otherwise unproductive for tax purposes. It is the view of this study however that he complaint is misplaced as these are potential taxpayers and therefore the earlier they get into the system the better.

3.4.2 Findings from Taxpayers

PIN is widely used. This is borne out of the fact that 100% of the respondents confirmed having it. They also recognize it as an identification tool. The other uses of PIN identified are accessing the KRA online portal. None of the respondents indicated an objection to the acquiring and use of the PIN.

3.4.3 Findings from Tax Professionals

PIN is the unique identification feature for tax administration, without which it would almost be impossible to identify whether or not payment of taxes has been made, and if so, by which entity. World over, in tax administration and identification of taxpayers, an identification number is usually allocated to a taxpayer. PIN is part and parcel of efficient and effective tax administration and collection.

PIN should be used not only for tax administration but also should be the feature that one has to make use to access any other government service. For instance, where

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³⁰⁷ Interview conducted with Mr. Juma, a Manager in the Policy, Compliance Risk Management & Research Division of KRA on 29th July 2013 at KRA offices, Times Tower, Nairobi.

the government of Kenya is still struggling to address the issue of non-compliance in tax affairs, then where all government services are linked to a number, then such services should be inaccessible to an individual who is non-compliant with their tax obligations. This was the reasoning behind the requirement of producing a tax compliance certificate prior to submitting a tender in a government institution as well as before applying for a job within the government.

In fact, the 13th Schedule to the Income Tax Act lists the various transactions for which PIN will be required. Going through that list, one cannot fail to notice that some of those transactions listed therein are actually those provided by the government under the various ministries or where the government is the major stakeholder. For instance, registration of motor vehicles, registration of titles and stamping of instruments, trade licensing among other transactions must be accompanied by the PIN of the applicant.

3.5 CONCLUSION

The PIN is widely used in Kenya. It leads to increased taxpayer compliance as it enables the identification of taxpayers. Its implementation complied with the reform rule of results. It has a positive impact on tax administration in Kenya.

Controls on the issuance of PIN should neither be too lax nor too strict as it would either affect the integrity of the system or leave out potential taxpayers. All registrable taxpayers should be captured. There should be no double registration. This may take the form of either issuance of two numbers to one taxpayer or issuance of the same number to more than one person. The concept of over-registration is a misnomer, as long as there is system integrity. As many taxpayers as possible should be registered.

Kenya being a constitutional democracy and taxation being provided for under the Constitution, the registration cannot be deemed to interfere with liberty and privacy unless it is too intrusive beyond necessary limits. A taxpayer identification and registration system is one of the limits to personhood and privacy that every person

living in an organized modern society should be ready to accept. Accordingly, the concern by Sobel that an identification system is a tool of an authoritarian regime is not convincing. Accordingly, suitable law would act in a manner of social engineering to make taxpayers appreciate the need.

The aspect of confidentiality and security of data is important. The system of registration should have enough safeguards to ensure its integrity.

During the colonial era, taxpayer registration and the national registration system (*kipande* system) were connected, mainly by their object which was to compel the African population into forced labour. This influenced the perception about an identification system. However, it has been established that such a system promotes efficiency and consequently development. A law promoting such efficiency should be seen as an instrument of development.

The Income Tax Act requires every person chargeable to income tax and any other person the Commissioner may deem a fit and proper person to obtain a PIN. It also provides for compulsory registration whereby a person required to register fails to do so.

Failure to share information by the national tax administrator with subnational entities is sometimes due to legislation forbidding it or administrative and political decisions. There is therefore need to reform legislation to ensure that it does not forbid such sharing of information or give room to discretionary powers of a political or administrative nature.

In some countries (for instance, Australia, Brazil and Spain) there is no provision for information exchange and no coordination or administrative integration. In others, there is cooperation and coordination including information sharing agreements, like in Germany. In the circumstances of Kenya's devolved system, information exchange and sharing would be useful for purposes of coordination in tax administration.

Separate identification and registration systems lead to duplication and the different levels of government cannot gain the benefits of information in the hand of another entity. This would neither lead to development nor would it be economical.

In conclusion, there is no need to have a personal registration and identification system at the county level as county taxes under the constitution are largely property-based or event-based, rather than individual-based. Even when counties get other taxes to administer, this thesis doubts the viability of a parallel identification and registration system. However, there may be need for counties to plug into the KRA PIN system for purposes of information sharing.

In the following Chapter, we discuss the concept of autonomous revenue authorities and their central place in tax administration.

CHAPTER 4

THE CONCEPT OF AUTONOMOUS REVENUE AUTHORITIES (ARAs)

In this Chapter, the research question addressed is whether the concept of ARAs is suitable for the administration of county taxes in Kenya. Accordingly, an attempt has been made to achieve the objective of analyzing and studying the concept of ARAs and the establishment of KRA to find out whether it has achieved its object and whether it can be sustainably devolved to the counties for the administration of county taxes.

4.1 RATIONALE FOR THE ESTABLISHMENT OF ARAS

The concept of ARAs was defined earlier in Chapter 1 and as noted then, the trend in many developing countries³⁰⁸ from the mid 1980s has been to set up ARAs to replace the offices or departments charged with collection of taxes as a perceived means to sustained revenue improvement. This was deemed a radical measure primarily intended to improve revenue performance due to the deep–seated problems in tax administration.³⁰⁹ This, however, sought to change the formal institution without the requisite social engineering through "leading" law reform. This was also bound to result in tax culture lag as the other parts remained largely unchanged.

In Chapter 1, it was noted that in sub-Saharan Africa seventeen (17) countries established autonomous revenue authorities in the period between 1985 and 2011 with a view to benefitting from the apparent advantages of ARAs.

Some scholars have justified the need for ARAs in Africa with the need to shift from neopatrimonialism³¹⁰ whereby the informal politics of the rulers in African states infringe on the collection of taxes thereby reducing state revenue. However, the

³⁰⁸ This is more pronounced in Africa.

³⁰⁹Manasan, R. G. (2003) *supra*, p. 173; Hadler, S. C. (2000) *supra*, p. 3; and Fjeldstad, Q-H and Moore, M. (2009) *supra*, p. 1.

³¹⁰ This entails the concentration of political power, the award of personal favours and the misuse of state resources.

hypothesis that neopatrimonial tendencies have an impact on revenue collection was disproved in a study conducted in Zambia. There is no linear correlation between neopatrimonialism and revenue collection.³¹¹

The spread of ARAs in sub-Saharan Africa has been viewed as driven by external forces. The main culprits have been the United Kingdom's Department for International Development (DFID), the International Monetary Fund (IMF) and the World Bank.³¹² Indeed, the Fiscal Affairs Department (FAD) of the IMF has provided advice and assistance in both revenue administration and tax policy matters to over 19 sub-Saharan African countries.³¹³ International financial institutions (IFIs) have, on an *ad hoc* basis, proposed the general adoption of the ARA reform.³¹⁴

The IMF has, for example, been severely criticized for the advice, conditions and conditionalities it gives to developing countries. Indeed it has been alleged that it has made mistakes in all the areas it has been involved in, ranging from development to crisis management. It has largely been seen as an obstacle to African development. Its "one-size-fits-all" approach often misleads the recipients of the advice.³¹⁵

Indeed it has been acknowledged that the proliferation of ARAs in sub-Saharan Africa is the most visible expression of technical donor support in strengthening tax administration as part of support towards public administration. The justification has

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³¹¹ Von Soest, C. (2006) "How does neopatrimonialism affect the African state? The case of tax collection in Zambia," *GIGA Working Paper No. 32*, generally.

³¹²Fjeldstad and Moore (2009) *supra*, p. 3; and Hadler (2000) *supra*, p. 4.

³¹³Kloeden (2011) *supra*, p. 4.

³¹⁴Taliercio, R. Jr. (2004) *Designing Performance: The Semi-Autonomous Revenue Authority Model in Africa and Latin America*, World Bank Policy Research Working Paper 3423, p. 2.

³¹⁵ See Stiglitz, J. (2002) *Globalization and its Discontents*, Penguin Books, London, generally. These accusations having been made by a former World Bank Chief Economist are strong. He explains his observations by giving illustrations. For instance, at page 32, he says:

[&]quot;The IMF had insisted on financial market liberalization, believing that competition among banks would lead to lower interest rates. The results were disastrous: the move was followed by the very rapid growth of local and indigenous commercial banks, at a time when the banking legislation and bank supervision were inadequate, with the predictable results – fourteen banking failures in Kenya in 1993 and 1994 alone. In the end, interest rates increased, not decreased."

been that African states have been deficient in this respect and exhibit consistent inability to collect taxes.³¹⁶

This external support in law and economic systems was part of the law and development movement as the donor agencies viewed it as a way to promote elaborate law reform. This system of ARAs appears to have been informed by the then approach in the law and development movement that the market was the best allocator of resources and accordingly revenue agencies should shift from the strict civil service structures to a private sector-type structure for efficiency purposes.

The establishment of ARAs in Africa was bound to suffer the negative effects of the tax culture shock and lag. The compatibility of the proposed systems with the environment had not been tested. Further, it clearly followed the false paradigm model of the international-dependence revolution approach. The international "expert" advisers may have been biased or uninformed.

Though autonomous revenue agencies were perceived as a means to sustained revenue improvement, there is little sign that their creation has actually increased public revenues. Indeed, between 1996 and 2007/08, the tax/GDP ratio for Kenya dropped by -2.3. It also dropped in Seychelles, Zambia and Zimbabwe over a similar period. However, it has facilitated a range of reforms in the ways in which taxes are assessed and collected. Average revenue collection increases across 40 sub-Saharan African countries between 1980 and 2005 are mostly, if not entirely, attributed to resources revenues, with collections in countries without resources mostly stagnant. Generally, it has been observed that donor support has not succeeded in the improvement of tax administration capability on a sustainable basis.³¹⁷

In Kenya, revenues have increased since the establishment of KRA. Revenue growth averaged over 11 per cent between 1995/96 and 2008/09.³¹⁸ However,

³¹⁸KRA (2010) *supra*, p. xv.

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³¹⁶ Von Soest, C. (2008) "Donor support for tax administration reform in Africa: Experiences in Ghana, Tanzania, Uganda and Zambia," *German Development Institute Discussion Paper No. 2/2008*, p. 1.

³¹⁷ Von Soest, C. (2008) *supra*, p. 34; Kloeden, D. (2011) *supra*, p. 7; Fjeldstad, O-H. and Moore, M. (2009) *supra*, p. 1; and Hadler, S. C. (2000) *supra*, p. 3; and, Manasan, R. G. (2003) *supra*, p. 173.

studies have not been conducted to satisfactorily confirm that the increase is as a result of the establishment of KRA or that they were bound to increase anyway due to factors such as a generally growing economy and the change in the political environment.

Whereas in Kenya and South Africa, the objective of establishing ARAs was to improve effectiveness, efficiency and equity of the tax administration, the objective in other countries such as Ghana, Uganda, Zambia and Tanzania was mainly to increase tax revenues.³¹⁹ As far as this objective is concerned, the establishment of KRA achieved its object. It should, however, not be lost that this object was set through economic advice and technical assistance from pro-capitalist governments and institutions.

As seen in Chapter 1, tax effort is an important measure in the performance of a tax system. Whereas in countries such as Malaysia and Zambia the creation of ARAs appears to have no tangible impact on tax effort, contrastingly, in Kenya, tax effort declined despite the creation of KRA.

The operating budgets of ARAs play an important role in the performance of the ARAs. This is because they determine the capability of the ARA to institute and perform functions. It also has a bearing on the quality and quantity of human resources at the disposal of the ARA. However, efficiency should be the guiding factor in the performance of an ARA as far as the available budget can allow.

ARAs generally receive budgets which are set as fixed (e.g. 2 percent for the SUNAT of Peru) or variable percentages (e.g. between 3 and 5 percent for the SENIAT of Venezuela) of their actual collections. The funding of the KRA of Kenya and MRA of Malawi is equal to a variable percentage of difference between actual and targeted collections in addition to a fixed percentage of actual collections, but the total should not exceed a given percentage of total collections. Whereas this may appear attractive in the sense that it is performance-linked, it may actually lead to strategic behaviour on the part of the revenue authority in the area of revenue

³¹⁹Hadler, S. C. (2000) *supra*, pp. 3-4.

target setting and may be counterproductive.³²⁰ This may lead to the loss of the social objective for which the institutions were set up.³²¹

The need to increase revenues has been the primary reason for establishment of most ARAs in sub-Saharan Africa. In some countries there were other special reasons for the establishment of the agencies. For instance, in Tanzania and Uganda, the disarray of revenue collection and pervasive corruption were the motivating factors, while in Kenya and South Africa, the objective was less to increase tax revenues than to improve effectiveness, efficiency and equity of the tax administration. All these have a positive correlation with development. 322

The rationale for establishing ARAs has been the need for radical changes in tax administration in countries where the tax gap is large. Tax administration in these countries was characterized by a rigid civil service, widespread perception of corruption and consequently, low voluntary compliance because of the perceived lack of fairness in the enforcement of tax laws. However, ARAs have not been a sustainable remedy against deteriorating employment conditions and corruption. Indeed as shall be seen later, sometimes their establishment causes more harm than good.

Revenue agencies are also given autonomy in an endeavour to make a credible commitment to taxpayers that the tax collection agency will be more competent, efficient and fair. The reform aim of turning over tax administration to an independent

³²⁰Manasan, R. G. (2003) *supra*, p. 178.

³²¹ For instance, Cheeseman, N. & R. Griffiths (2005) *supra*, p. 20, observe that "there is some evidence that the Kenyan government has over-estimated the tax revenue that will be collected in future years as a way of presenting international organisations with a balance budget." Whereas this study considers this as a possibility, Cheeseman & Griffiths do not provide the evidence or the source.

³²²Hadler, S. C. (2000) *supra*, p. 4.

³²³ It is noteworthy that whereas the foreign "experts" would term the civil service as rigid, this is the same civil service structure inherited from the colonial masters of whom the "experts" are an appendage.

³²⁴ It does not necessarily follow that the creation of an autonomous revenue agency would eliminate corruption without addressing the causative effects.

³²⁵Manasan, R. G. (2003) *supra*, p. 174.

³²⁶ Von Soest, C. (2008) *supra*, pp. 36-37.

agency is to depoliticize tax collection³²⁷ and minimise the risks that politicians will undo the reform at a later date with a view to curb neopatrimonial tendencies. ³²⁸

As noted earlier, there are numerous apparent benefits of establishing ARAs. These include perceived increased effectiveness, efficiency and equity of a new agency by taxpayers, resulting in an increase in compliance and tax revenues; greater flexibility in human resource management free from the constraints of public service regulations; to restructure and integrate tax operations so as to take advantage of economies of scale and information, and to eliminate duplication of functions; and independence to take legal action directly against taxpayers.³²⁹

The disadvantages of the revenue agency approach include the possibility that improved revenues could be realized without the costs of establishing a new agency. The establishment of a new agency may be promoted by those who stand to benefit³³⁰ and have proven more costly than the tax agencies they replace. Indeed in some cases, the collection costs to tax revenue ratio have increased. The establishment of ARAs is not a sustainable alternative to civil service reform, and may contribute to fragmentation of the civil service and to problems of inter-agency co-operation. There is need for a clear regulatory and supervisory framework to ensure that autonomy is not abused since autonomy does not guarantee an end to political interference. Further, legal and political factors may continue to constrain human resource policies leading to the non-realisation of the intended objectives. ³³¹

The establishment of an ARA leads to the clouding of the other roles that the various departments are supposed to play and subordinate them to revenue collection. Whereas revenue collection is the main purpose of a taxation authority, it is not the

Autonomous revenue agencies still have political relations. The Chairman of the board of KRA, for instance, is appointed by a politician, the President. The relationship of the SARS leadership to politics has been dealt with earlier.

³²⁸Manasan, R. G. (2003) *supra*, p. 175.

³²⁹Hadler, S. C. (2000) *supra*, pp. 4-5.

³³⁰ For instance, where the Ministry of Finance administers tax and there is an intention to establish an ARA, officers of the same ministry would be involved in conceiving and effecting the idea and indeed will eventually become the first officers in the newly created ARA for purposes of continuity.

³³¹Hadler, S. C. (2000) *supra*, pp. 6-8.

only one. For instance, the role of the customs department ranges from intellectual property rights enforcement and protection (through anti-counterfeit mechanisms) to trade facilitation and anti-money laundering efforts. In an ARA, which is a revenue collection agency, the performance of a department would be gauged on the amounts of revenue collected.³³²

Indeed, the establishment of an ARA creates a monolithic behemoth that brings new management problems. The head loses touch with the base. The individual departments lose their technical independence and the enforcement potency is lost.

Most ARAs are found in African countries and in Latin America. The ARA model has mainly been supported by three international aid and development organizations - DFID, IMF and the World Bank – which have also supported the introduction of New Public Management reforms in poor countries. There is therefore the view that the spread of ARAs in sub-Saharan Africa is part of a project to remodel the public sector along New Public Management (NPM) lines, with the agenda of trying to reduce the authority of the state and shift power to the market. However, according to Fjeldstad and Moore, this interpretation, while superficially plausible, is wrong. ARAs are a vehicle for increasing tax revenues and thus increasing the authority of the (central) state as the state would have more funds at its disposal to entrench its presence. 333

ARAs differ from one another in many respects, but they share significant features. The agency is granted, in law, some autonomy from central executive power, partly

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In an apparent appreciation that the concept of an all-encompassing ARA is not necessarily the best model, the *Report of the Presidential Taskforce on Parastatal Reforms* submitted to the President of the Republic of Kenya in 2013 recommended that KRA should be renamed the Internal Revenue Service (IRS) as it would not handle the customs function. The Customs Department would be transferred to the Kenya Citizens and Foreign Nationals Management Service, which would be renamed the Customs, Border Management and Security Service. It is, however, intended that the revenue arising from customs and border management activities would still be collected by the KRA. This leads to the question of the viability of the dual control and management. The rationale given for this is the need for a 'unified and seamless management of customs, immigration and border security and control'. This is also based on best practice observed elsewhere.

³³³ Manasan, R. G. (2003) *supra*, p. 173; and Fjeldstad, O-H. and Moore, M. (2009) *supra*, pp. 2-3.

with the purpose of limiting direct political interference in its day to day operations. It is also meant, in principle, to be quite independent of the financing and personnel rules that govern the public sector in general. All central government tax operations are integrated into one single-purpose agency. It has not always been possible to bring all tax operations under one agency due to the varying characteristics of taxes but an ARA is an attempt towards that end. ³³⁴

The key design features that define semi-autonomous revenue agencies have been identified as hereunder.

a. Legal character

They are all created by law, which also defines their legal character. Peru's National Tax Administration Superintendency (SUNAT) is a decentralized public organization. The South African Revenue Service (SARS) is a public sector organization outside the public service. The Kenya Revenue Authority (KRA) is a government corporate body. All of these have their own separate legal character and can own assets.

b. Governance Structure

The semi-autonomous revenue agencies follow any one of two governance models: the Chief Executive Officer (CEO) model or the board of directors (BOD) model. The former is popular in Latin America and the latter in Africa and Asia. Under the BOD model, the board of directors is responsible for overseeing the management of the agency but does not intervene in the day-to-day activities of the revenue authority. 335

c. Financing

Semi-autonomous revenue agencies receive budgets which are set as fixed or variable percentages of their actual collection. The funding of the KRA of Kenya and MRA of Malawi is equal to a variable percentage of difference between actual and targeted collections in addition to a fixed percentage of actual

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³³⁴Fjeldstad, O-H. and Moore, M. (2009) *supra*, p. 3.

³³⁵ This has more to do with corporate governance concerns than tax administration.

collections, but the total should not exceed a given percentage of total collections.

d. Personnel systems

The availability and retention of trained human resources are deemed to be the most important factors in determining the efficiency of tax administration. However, civil service rules are deemed too strict for tax administration. However, relaxing rules for hiring of staff can be an avenue for rent-seeking.

e. Accountability mechanisms

The components of a good accountability system are a code of ethics for all employees of the tax authority; a strong internal audit unit with a high profile within the revenue authority itself; and clear reporting relationships to other government agencies.³³⁶

Though most ARAs were created to increase government revenues, they have contributed little to that goal. Indeed, establishing ARAs has the potential to create new problems as it solves old ones. Their creation poses a threat to the synchronization of tax collection and tax policy as an ARA may not easily and seamlessly implement government policy as soon as it is formulated. 337

ARAs have been less sustainable than expected. This has been so even in countries that have shown some degree of success with the ARA model. Indeed in some there is evidence that the gains in revenue performance tends to be eroded after some time. It has been argued that the main challenge to the autonomy of the RA has been the government itself due to conflicts and competition between the ARA and the government. However, the degree of autonomy still has an impact on the success of an ARA. 338

³³⁶Manasan, R. G. (2003) *supra*, pp. 176-180.

³³⁷Fjeldstad, O-H. and Moore, M. (2009) *supra*, pp. 13-14.

³³⁸Manasan, R. G. (2003) *supra*, pp. 183-185.

As noted earlier, ARAs are not a universal solution for tax administrations. They cannot be guaranteed insulation from political interference. The establishment of a new agency is not always necessary, and care needs to be given to the establishment costs in relation to revenue gains. Indeed it may lead to an undesirable consequence on economic efficiency. 339

The South African experience deserves a special mention for two reasons. First, the revenue authorities of Kenya and South Africa were established around the same time and secondly because they were established for the same reason, i.e. to increase efficiency in revenue collection and not strictly to increase revenue levels.

As seen earlier, the first steps in the reform of the tax administration in South Africa took place in 1995 when the Inland Revenue and Customs and Excise Directorates in the Department of Finance were converted into the South African Revenue Service (SARS). SARS introduced specific measures to improve efficiency of tax collection thereby reducing the tax gap.³⁴⁰

Though SARS was established two years after the KRA, SARS is more successful than KRA despite the fact that the objective of establishing both institutions was common. This is notwithstanding that SARS is still prone to political interference. Independence and autonomy may not therefore be considered the key indicators of the success of a tax administration.

The South African tax collections in the fiscal year 1999 exceeded 27 percent of GDP. The government pledged to reduce it to 25 percent.³⁴¹ This underscores the point that an increase in revenue collection is not necessarily the measure of success of an ARA. More considerations based on the sociological foundations and other factors of economic analysis should be taken into account.

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³³⁹Hadler, S. C. (2000) *supra*, p. 11.

³⁴⁰Manuel, T.A (2002) "The South African Tax Reform Experience since 1994, " address by the Minister of Finance to the Annual conference of the International Bar Association, October 25, p. 3.

³⁴¹Aaron, H. J. (2009) *supra*, p. 2.

In Chapter 1, we saw that SARS is considered a consistent success story. That is why its staff members are even engaged to support other ARAs in the region. But it is not free from political interference. The Chief Executive is always a senior politician and neopatrimonial tendencies are still rife. This supports the findings referred to earlier based on a Zambian study that there is no linear correlation between neopatrimonialism and revenue collection.

ARAs in developing countries still face challenges related to under-resourced or under-trained administrators, poor tax collection systems, failure of legal enforcement mechanisms for tax collection and small penalties for non-payment. These lead to tax leakage. 342

4.2THE OPERATION OF THE KRA

The Kenyan Revenue Authority was established in 1995 under the Kenya Revenue Act³⁴³ as the central body for the assessment and collection of revenue and for the administration and enforcement of the laws relating to revenue.³⁴⁴

KRA was set up to collect and account for all government revenue³⁴⁵ under a semiautonomous arrangement.³⁴⁶ This brought together the previously independent revenue collection departments.347 It was intended to improve revenue administration and enhance mobilization of domestic resources. The overall objective was to improve effectiveness, efficiency and equity in revenue administration. Admittedly it was established as a measure to keep up to

³⁴² Fakile, A. S., F. F. Adegbie & O. S. Faboyede (2014) *supra*, p. 104.

³⁴³Chapter 469 of the Laws of Kenya, whose commencement date was 1st July 1995.

³⁴⁴The Preamble to the Act.

³⁴⁵ Government revenue includes taxes and other sources of government revenue. KRA is therefore not just a tax collection body.

³⁴⁶Kenya Revenue Authority (2010) *supra*, p. 13.

³⁴⁷These were departments in the Ministry of Finance. They included the Customs & Excise department, the Income Tax department and the VAT department.

international best practice. It has been noted earlier that this happened as a result of advice from western donor organizations. 348

In terms of section 5 of the Act, KRA is an agency of the government for the collection and receipt of all revenue. However, it is under the general supervision of the Cabinet Secretary in charge of the Treasury. This brings into focus the claim of its independence. The jury is still out as to whether there is any material difference between the independence it enjoys and that enjoyed by the hitherto revenue collection departments within the ministry.

KRA is only empowered to administer and enforce specific statutes. These are set out in Part I and Part II of the First Schedule to the Act. For the Part I statutes, it administers and enforces all provisions while for Part II statutes, its power only extends to the specified provisions.³⁵⁰

Part I statutes are the Income Tax Act,³⁵¹ the Customs and Excise Act,³⁵² the Value Added Tax Act,³⁵³ Road Maintenance Levy Fund Act,³⁵⁴ Air Passenger Service Charge Act,³⁵⁵ Entertainments Tax Act,³⁵⁶ the East African Community Customs Management Act, 2004, and the Annexes to the Protocol on the Establishment of the East African Community Customs Union. The Part II statutes are the Traffic Act,³⁵⁷ Transport Licensing Act,³⁵⁸ Second Hand Motor Vehicles Purchase Tax Act,³⁵⁹ the Civil Aviation Act,³⁶⁰ the Widows and Children's Pensions Act,³⁶¹ the Parliamentary

³⁴⁸Kenya Revenue Authority (2010) *supra*, p. 13.

³⁴⁹Previously Minister for Finance.

³⁵⁰Section 5(2).

³⁵¹Chapter 470, Laws of Kenya.

³⁵²Chapter 472, Laws of Kenya.

³⁵³ Chapter 476, Laws of Kenva.

³⁵⁴ Act No. 9 of 1993.

³⁵⁵ Chapter 475, Laws of Kenya.

³⁵⁶ Chapter 479, Laws of Kenya.

³⁵⁷Chapter 403, Laws of Kenya.

³⁵⁸Chapter 404. Laws of Kenva.

³⁵⁹ Chapter 484, Laws of Kenya.

³⁶⁰ Chapter 394, Laws of Kenya.

Pensions Act³⁶², the Betting Lotteries and Gaming Act³⁶³, the Stamp Duty Act,³⁶⁴ the Horticultural Crops Development Authority (Imposition of Fees and Charges) Order 1995,³⁶⁵ the Standards Levy Order 1990,³⁶⁶ the Sugar Act³⁶⁷ and the Government Lands Act.³⁶⁸

The foregoing means that the KRA has been in charge of the full implementation of the Entertainments Tax Act and partial enforcement of the Betting, Lotteries and Gaming Act. These entail entertainment tax. Entertainment taxes are now under the jurisdiction of county governments. Further, due to its power to collect stamp duty under the Stamp Duty Act and land rent under the Government Lands Act (now repealed), it has also been involved in the administration of property taxes. Property rates are now under the jurisdiction of the county government. As will be seen in Chapter 5, property rates are just one typology of property taxes. The Constitution is emphatic on property rates but silent on other property taxes.

KRA is governed by a board of directors comprising of chairman appointed by the President, the Commissioner–General, the Principal Secretary, ³⁷⁰ Treasury or his representative, the Attorney–General or his representative, and six other persons

³⁶¹ Chapter 195, Laws of Kenya.

³⁶²Chapter 196, Laws of Kenya.

³⁶³ Chapter 131, Laws of Kenya.

³⁶⁴ Chapter 480. Laws of Kenva.

³⁶⁵Legal Notice No. 225 of 1995.

³⁶⁶Legal Notice No. 267 of 1990.

³⁶⁷Act No. 10 of 2001.

³⁶⁸ Chapter 280, Laws of Kenya (now repealed).

³⁶⁹ It is debatable whether stamp duty falls under the property rates envisaged under the Constitution as being under the jurisdiction of the counties. Whereas it is beyond the scope of this research to deal with substantive taxation matters, a clear understanding of the reach of property rates will be achieved after considering the issues addressed in Chapter 5.

³⁷⁰Previously, Permanent Secretary, which title is still in the Act.

appointed by the Cabinet Secretary³⁷¹ for Treasury.³⁷² Only the chairman and the six other appointees have voting powers.³⁷³

The board has three main duties. These are, the approval and review of the policy of the Authority; the monitoring of the performance of the Authority in the carrying out of its functions; and the discipline and control of all members of staff of the Authority.³⁷⁴ This means that even though the board is not designed as an executive board, it performs executive functions. This is in line with the BoD model.

The Commissioner–General is the chief executive of the authority. He is appointed by the Treasury Cabinet Secretary upon recommendation of the Board. He operates under the general supervision and control of the Board. He is responsible for the day to day operations of the Authority; the management of funds, property and affairs of the Authority; and the administration, organization and control of the staff of the Authority.³⁷⁵

The Board has power to appoint Commissioners to the service of the Authority.³⁷⁶ In exercise of this power it has appointed Commissioners for Domestic Taxes, Customs Services, Large Taxpayers Office, Road Transport, and Support Services.³⁷⁷ The Commissioner–General with the approval of the Board has power to appoint functional heads of departments.³⁷⁸ It is noteworthy that the Commissioner–General has power to transfer the functions of departments or merge departments with the

³⁷¹Previously, Minister, which title is still in the Act.

³⁷²Section 6(1) and (2), Kenya Revenue Authority Act.

³⁷³Section 6(5) Kenya Revenue Authority Act.

³⁷⁴Section 6(6) Kenya Revenue Authority Act.

³⁷⁵Section 11.

³⁷⁶Section 13(1).

The KRA has created a new position of Commissioner for Enforcement and Investigations. In July 2013, the Authority advertised for the position. It has also established the Medium Taxpayers Office.

³⁷⁸Section 13(2).

approval of the Minister, and not the Board. This undermines the authority of the KRA Board. 379

The revenues collected by the Authority are paid into the Consolidated Fund except where the revenue is in respect of a special fund established under an Act of parliament to which it is paid.³⁸⁰

The funds of the Authority consist of one and one—half percent of the revenue estimated in the financial estimates for each financial year to be collected by the Authority; and three percent of the revenue actually collected in each successive three month period in the financial year in excess of the amount estimated to be collected in respect of the period. However, the total should not exceed two percent of the actual amount collected in respect of that period.³⁸¹

This means that where the revenue estimated in the financial estimates for the year equals X, and the actual revenue collected for the year equals Y, then the funds of the Authority for the year would be equal $to\frac{1\frac{1}{2}}{100}X + \frac{3}{100}(y-x)$ provided that $\frac{2}{100}y > \frac{1\frac{1}{2}}{100}x + \frac{3}{100}(y-x)$

It is however noteworthy that the $1\frac{1}{2}$ % of revenue estimates is payable in equal monthly instalments at the beginning of the month³⁸² and the 3% of revenue actually collected in excess is payable within one month after the end of the three month period.³⁸³

³⁷⁹Section 13A. This is clearly a remnant of the direct political interference that the creation of an ARA may have wanted to eliminate. The Commissioner-General, as a supervisee of the Board, should have recourse only to the Board.

³⁸⁰Section 15.

³⁸¹Section 16, other funds includes loans and grants received by the Authority and any other monies as may be received by or made available to the Authority, both requiring the approval of the Minister.

³⁸²Section 16(2) (a).

³⁸³Section 16 (2)(b).

KRA identifies itself as a successful public sector organization. This is because since its inception in 1995, it has often exceeded revenue targets. These are targets set by KRA itself. Revenue growth for the period between 1995/96 and 2008/09 averaged over 11 per cent.384

Tax collection responsibilities at the KRA are divided into the Domestic Taxes Department (DTD), the Customs and Excise Department (CED), the Large Taxpayers Office (LTO) and the Medium Taxpayers Office (MTO).

KRA blames the failure to achieve its objectives on underfunding.³⁸⁵ This is notwithstanding the fact that its funds are provided for under statute. It is, however, noteworthy that KRA does its own revenue projections and expenditure estimates.³⁸⁶

The ability of KRA to continue carrying out its mandate has been doubted unless the underfunding problem is solved. The Auditor General qualified the KRA 2010/11 accounts as follows:

"...it is a matter of concern that the Authority has in the past four years posted negative results. Further, the Authority reported a negative working capital of Ksh. 405,052,000.00 as reflected in the statement of financial position as at June 30, 2011. The Authority's ability to carry out its mandate in the long run is therefore under threat". 387

Observers feel that the establishment of KRA has failed to lead to a dramatic increase in revenues. This becomes even the more prominent when one considers the amount of time and money expended on KRA and tax administration generally. On the positive side, KRA is seen just as a gloss of legitimacy to Kenya's tax administration.388

³⁸⁴KRA (2010) *supra*, p. xv.

³⁸⁵ It is noteworthy that in KRA (2010) *supra*, it considered itself as a successful organization on the basis of achieving revenue targets.

³⁸⁶KRA (2012) *supra*, p. 22.

³⁸⁷*Ibid*.

³⁸⁸ Cheeseman, N. & R. Griffiths (2005) *supra*, pp. 12-13.

4.3 DEVOLUTION OF REVENUE AUTHORITIES TO THE COUNTIES

A key principle of devolved government is that county governments must have reliable sources of revenue to enable them govern and deliver services effectively. This demands an effective revenue administration.

Every county government has a Revenue Fund into which should be paid all revenue of the county government.³⁹⁰ The management of County Revenue Funds is provided for by the national legislation and the county legislation,³⁹¹ and regulated by the Controller of Budget.³⁹²

The only taxes that are subject to the administration of the county are property rates, entertainment taxes and any other tax authorized by an Act of Parliament³⁹³. County governments may also impose charges for services.³⁹⁴

In the administration of its revenue, a county must not act in a manner that prejudices national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labour.³⁹⁵

The County Revenue Fund is administered by the County Treasury.³⁹⁶ The County Treasury comprises of the County Executive Committee member for finance (who is the head), the chief officer and the department or departments of the County Treasury responsible for financial and fiscal matters.³⁹⁷ Among the responsibilities of

³⁸⁹Article 175(b), Constitution of Kenya, 2010.

³⁹⁰Article 207(1), Constitution of Kenya, 2010 and section 109 (1)and (2), Public Finance Management Act, 2012, Act No. 18 of 2012.

³⁹¹Article 207 (2) and 4.

³⁹²Article 207 (3).

³⁹³Article 209 (3).

³⁹⁴Article 209 (4).

³⁹⁵Article 209 (5). An exposition of this concept is done in Chapter 5.

³⁹⁶Section 109(3), Public Finance Management Act, 2012.

³⁹⁷Section 103, *ibid*.

the County Treasury is to put in place mechanisms to raise revenue and resources. 398

It is clear that the County Revenue Fund is the equivalent of the Consolidated Fund at the national level.

Whereas it appears settled that the County Treasury is the Revenue Authority at the County level, it is debatable whether it can be deemed an autonomous revenue agency. It is akin to the revenue departments that existed within the Ministry of Finance at the national level before the establishment of KRA, the difference being that it administers the whole revenue inventory without provision for a specific department for a specific tax.

There is a possibility that KRA may be called upon to collect revenue on behalf of counties. Whereas KRA is a collector of national government revenue, under the Public Finance Management Act, the counties may authorize it to be a collector of county government revenue. This would take advantage of its comparative advantage and economies of scale. However, this may bring challenges in physical infrastructure as KRA does not have offices in all counties.³⁹⁹

The bigger challenge is that whereas counties have an option of allowing KRA to collect revenues on their behalf, the law does not give it the full legal mandate to collect the revenue due to the counties. It can only do so as an agent of the county governments.⁴⁰⁰

It should however be noted that the establishment of offices in the counties by KRA has no legal implication for county taxes. By doing so, KRA would only be strengthening its capacity to administer revenue due to the national government and not county governments. Under the concept of devolution therefore, this study would

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³⁹⁸Section 104, *ibid*.

³⁹⁹KRA (2012) *supra*, p. 27.

⁴⁰⁰*Ibid*.

only view as KRA equivalents at county level any attempts by county governments to establish ARAs to administer taxes due to them.

4.4 PRIMARY RESEARCH FINDINGS

The research methodology applied is described in Chapter 1.

4.4.1 Findings from KRA Officers

Majority of the respondents were of the view that the autonomy of KRA has enabled it to execute its mandate with minimal external influence. It has also enabled it to plan well under predictable resource availability from the National Treasury. KRA is guided by its three-year Corporate Plan as spearheaded by the Board of Directors and management. Decisions can be implemented faster without much bureaucracy.

Autonomy also makes it easy to consolidate revenues and identify areas of non-compliance. The specialisation on tax collection has also enabled KRA to attract and train staff on tax matters thereby creating an efficient workforce. It also gives KRA an opportunity to forge relations with external persons and taxpayers. Sharing of information between departments is easy hence enhancing efficiency. The autonomy has also reduced political interference in tax administration.

The question on the effectiveness of a consolidated administration of taxes as compared to independent departments is answered in favour of a consolidated system. This is hailed as the best practice where all taxes and levies are collected by a single institution. This would lead to huge savings in costs on both the government and taxpayers. This would reduce the cost of paying taxes and improve the country's rating in the Doing Business Report of the World. KRA collects levies on behalf of various institutions. The government has also directed that NSSF contributions should be collected by KRA with a view to reducing the cost of collection on the taxpayers.

Consolidated administration is also considered better as it makes it easier to detect, audit and collect different taxes from the taxpayer if they are demanded from a central point. It is also fair and predictable for the taxpayer. A one-stop-shop increases efficiency, prevents overlapping of duties and makes it easier to handle complaints. The administration cost is minimised. Consolidation enables the agency to monitor the market. The downside of consolidation would arise where officers are not knowledgeable on taxes across the board. Accordingly, where tax is administered by independent units, there is specialisation that enhances efficiency and effectiveness in tax collection.

4.4.2 Findings from Taxpayers

Measured on a scale of poor, fair, good and excellent, 57.14% of the respondents rated the efficiency of KRA as good while 42.86% rated it as fair. This was measured on the basis of customer services, response to enquiries, resolution of disputes, among other considerations.

85.7% of the respondents indicated that they would rather pay taxes to KRA as a centralized body as opposed to 14.3% who indicated that dealing with separate and independent tax departments would be better. Those for separate and independent tax departments felt that this would inject expertise into the various departments. The respondents who are for a centralized KRA had various reasons. A centralized KRA makes it easy to administer taxes as a one-stop shop as it saves time. It also leads to efficiency and avoids duplication of roles, such as auditing. KRA also holds educational seminars for taxpayers and this makes it a tax collector of choice.

4.4.3 Findings from Tax Professionals

Initially, tax administration was segmented into the various departments based on, to some extent, the legislation governing a particular aspect of taxation. In this regard, Income Tax was administered under the Income tax department, Value Added Tax under the VAT department and Customs and excise under Customs Department.

Income tax department and VAT department were merged to form the domestic taxes department. However, Customs is still administered under the Customs

department. The merger leading to domestic taxes has led to efficiency in handling tax audits since the same team gets to use the same information in undertaking an audit. Previously, however, a situation that is now prevalent in Customs, the various departments used to act and behave like two different government agencies, even worse, different governments, each with different objectives. For instance, whereas the domestic taxes would be find favour in reduced costs of goods (purchases), the VAT and Customs department would insist on higher costs of goods. This is because VAT and Customs charges are based on the value of the goods transferred and/or imported into the country. From the above, it is clear that there is a mismatch in the agenda for tax collection between the various departments within KRA. More still needs to be done since this problem has not been completely resolved with Customs still being run as a different arm of the KRA.

4.5 CONCLUSION

As discussed, setting up of ARAs was perceived as a means either to improve revenue performance or boost effectiveness, efficiency and equity in tax administration. This was mainly because the existing systems had deep-seated problems.

The establishment of ARAs has been driven by external forces. As a result culture shock and lag were bound to occur. The implementation also exhibited signs of bias or lack of information on the part of the technical advisers. It is noteworthy that it has been deemed to be international best practice to establish ARAs. However, in an endeavour to split customs service and internal revenue functions, the basis that has been cited is still best practice. For purposes of customs, there is an intended transfer of authority to the East African Community vide the East Africa Customs Management Act.

Whereas the creation of ARAs was expected to increase revenue, there is no evidence that their creation increased public revenues. The funding formula for ARAs may also lead to the loss of the social objective for which they were set up.

The establishment of ARAs was hailed as a means of implementing radical changes in the tax administration to deal with the effects of a rigid civil service, corruption and as an attempt to depoliticize tax administration. ARAs have a legal character; adopt either the CEO or BOD model; have a budget which is either fixed or a variable percentage of their collections; do not follow strict civil service rules in human resource management; and, have a code of ethics for employees.

It has been observed that the establishment of ARAs clouds other roles of taxation and revenue generation becomes the prominent objective as a result of competition between departments. The departments lose their technical independence and enforcement potency. The creation of ARAs also poses a threat to the synchronization of tax collection and tax policy.

ARAs are not a universal solution for tax administrations and cannot guarantee insulation from political interference. For instance, it has been noted earlier that the CEO of SARS since its inception has always been a senior member of the ANC. Accordingly, political interference is not a justifiable reason for the establishment of an ARA.

There is debate as to whether the creation of ARAs increases or reduces the authority of the state vis-à-vis the market. The enhancement of the authority of the state has the potential to defeat the objects of devolution of reducing the powers of the central state and involve more of public participation.

KRA is under the general supervision of the Cabinet Secretary in charge of the Treasury. Indeed he appoints the members of the Board. The Chairman is appointed by the President and the ex-officio members are public servants. The argument that it is independent therefore cannot hold, especially in the face of the neopatrimonial nature of Kenyan politics.

The use of revenue targets as a measure of efficiency is debatable. KRA sets its revenue targets. Ordinarily, it always exceeds those targets. Its revenue collection determines the funds available to it for its operations.

KRA is divided into departments. Whereas those departments are mainly functional departments as opposed to revenue based, there is still the element of revenue sources being used as the basis for creation of departments.

KRA has had serious challenges. On its part, it has cited underfunding as a major problem. This is notwithstanding that its funding is set under statute. Increasing of funds for KRA may not be cost effective and may defeat the purpose for which it was established.

KRA has sufficient autonomy to carry out its functions. It operates on the basis of successive three-year corporate plans. Whereas this would appear contradictory to the argument that it is not independent from the political class, the autonomy does not necessarily lead to independence. The autonomy relates to the day to day functioning of the Authority.

Largely, the efficiency of KRA has been rated as good. The existence of KRA makes it easy to administer taxes and taxpayers feel that this saves time and leads to efficiency. However, as seen earlier in Chapter 1, the tax revenue/GDP ratio dropped in the first decade of KRA's operation thereby raising doubt as to its effectiveness. It is therefore debatable whether the establishment of KRA has satisfied the basic rules of reform.

KRA administers taxes and other levies vide 18 statutes. This significantly and numerically differs from the taxation powers of counties which administer only two taxes and other levies. It would therefore appear the economies of scale that may apply at national level may not be felt at the county level.

The nature of taxes administered by counties may not, by their very nature, call for a centralized administration system. This is because property rates attach to a specific property and not necessarily to the taxpayer and entertainment tax is event-based. Even when the counties eventually get other taxes in their basket, it is unlikely that such taxes will be all encompassing in the nature of income tax or VAT.

Counties must, however, ensure that the benefits that would come with an ARA are not lost because of its absence. The County Treasury should, as far as is practicable, infuse private sector-type efficiency in tax administration. There should be greater flexibility in human resource management and an attempt must be made at depoliticization of tax administration. Tax, and other revenue administration officers, must be made to operate under a code of ethics.

The following Chapter discusses the use of electronic and automated systems as a means of achieving efficiency in tax administration for development.

CHAPTER 5

ELECTRONIC AND AUTOMATED SYSTEMS AS A MEANS OF ACHIEVING EFFICIENCY FOR DEVELOPMENT

This Chapter seeks to address the question whether the electronic and automated systems in use by KRA are suitable for the administration of county taxes in Kenya. It attempts to deal with the issue as to whether these systems or their equivalents can be used as a means of achieving efficiency for development. The objective sought to be achieved is to investigate whether the electronic and automation systems introduced in Kenya in the reform of tax administration have achieved their objectives and whether they or their equivalents would be suitable for the administration of county taxes.

5.1 RATIONALE FOR THE USE OF ELECTRONIC AND AUTOMATED SYSTEMS

Electronic and automated systems involve the use of information and communication technologies, computers and other electronic means in tax administration. The main purpose for this should be to enhance efficiency and as a result achieve the overall development goals of a tax regime.

Changes in technology may influence tax administration. However, technology is not a "magic bullet" to solve all taxation problems. It may, however, be part of the answer. This largely depends on how well the technology fuses with the existing tax administration regime and the circumstances of the intended users.⁴⁰¹

There is a need to review tax and customs laws and administration to ascertain their adequacy in the face of electronic commerce and to remedy as required. In doing so, measures should be taken to avoid long term negative impact on the tax culture. 402

⁴⁰¹ Bird, R. M. and E. M. Zolt (2008) *Technology and Taxation in Developing Countries: From Hand to Mouse*, p. 4.

⁴⁰²Hadler, S. C. (2000) *supra*, p. 12.

The impact of electronic commerce is such that it has been extremely effective in strengthening businesses and strengthening economic growth and innovations in new areas. Costs are saved in B2B e-commerce and leads to higher GDP growth. ESD also offers governments new opportunities and ways of doing business. Governments and their tax administrations cannot afford to delay addressing electronic commerce both to benefit from the innovations and to relate with taxpayers on similar platforms. 403

Computerization is an essential element for modernizing tax administration. The tax administration must keep up with the pace of computerization in major economic sectors, including banking, trade and communications. Experts claim that the pace of computerization in tax administration in many countries has been slow. This is notwithstanding the advantages that would obtain, including increased capacity to process return and payment forms, compile statistics and improve revenue forecasting.⁴⁰⁴

The benefits of computerization are enormous. However, it must be ensured that development of the tax administration's computer technology is carried out in tandem with appropriate changes in the tax administration's key procedures, including registration, collection, audit and enforcement. Without this, there is the risk that computerization will not result in greater effectiveness in the tax administration's operations because inadequate procedures may have been computerized. Further, the resultant cultural lag may not be healthy for overall reform measures. 405

The type and organization of the tax administration and the degree of centralization or decentralization of operations will determine the kind of computer systems which will be required and the appropriate location of the computer systems that compile and store detailed information on taxpayers' accounts. Tax administrations ordinarily

⁴⁰³*Ibid*, pp. 12-13.

⁴⁰⁴Silvani, C. and Baer, K. (1997) *supra*, pp. 19-20.

⁴⁰⁵*Ibid*, p. 20.

outsource to professionals for the supply of computer hardware and software within the specifications provided. 406

This study takes the view that it would be more efficient to decentralize functions such that the entry and storage of detailed data on taxpayers' accounts is done at the local tax office, which is nearest to the taxpayer, and only summary data for purposes of reporting and management is transmitted to the regional and central tax offices. This is because excessive centralization of systems usually results in rigidities, lack of user participation, delays in detecting and correcting input errors, and a reduction in the usefulness of computer systems. Extremely decentralized systems are also difficult to administer because training of staff and maintenance of hardware and software become costly and demand great efforts. This may only be relevant for the computerization of KRA services for national taxation as those offered counties are independent of the KRA systems.

As seen earlier, a tax administration should maintain a degree of autonomy in designing its own computer systems. The dependence on systems working in other jurisdictions may not auger well for local conditions. It may have a causative effect on collective tax culture shock.

ESD can provide enormous gains in effectiveness and efficiency for all branches of tax administration. These include the simplification and streamlining of operations, creating more cost-effective administrations, improving compliance and timeliness and providing improved and convenient services. It is quite useful in customs, where technological change is at the heart of business process re-engineering. The era of globalization has contributed to increased activity for tax administrations worldwide and ESD offers the means to deliver expanded and improved services at constant or declining real cost. ESD can be an extremely important means to supporting the basic strategic objectives of a tax administration, namely simplification, efficiency,

⁴⁰⁷*Ibid*.

 $^{^{406}}Ibid$

equity and accessibility. This is in tandem with the overall development goal and is supported by the theory of economic analysis of law and the canons of taxation.⁴⁰⁸

ESD would therefore lead to an efficient tax administration that also makes a good attempt at fulfilling some of the canons of taxation. This would reduce the cost of tax administration, simplify the role of taxpayers and contribute to the achievement of the overall development goals.

Enabling choice on the part of the taxpayers from a variety of channels should be a key objective of ESD in tax administrations. However, more often than not, taxpayers are required to use a predetermined system run by the tax administration and therefore there is not much of a choice.⁴⁰⁹

In instances where electronic commerce is used there is the potential for avoidance and evasion. It becomes a challenge to the existing systems and laws. Countries, of necessity must, review their tax policies and administration to ensure that tax laws are applied appropriately. By its very nature, electronic commerce is multi-jurisdictional (and it does not respect geographical jurisdictions, which eventually determine the legal jurisdiction) and therefore there are challenges in determining where the commercial activity occurs and hence the jurisdiction with the authority to levy tax.

Recommendations have been made relating to the tax and regulatory environment. These include and state that:

- (i) Governments should create a favourable policy and legal environment for electronic commerce and ensure that the network and physical infrastructure for electronic commerce feature prominently in their policies and programs.
- (ii) Governments should ensure a tax neutral position with regard to electronic commerce transactions so as to avoid new or additional taxes driving business elsewhere.

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⁴⁰⁸Hadler, S. C. (2000) *supra*, pp. 13-15.

⁴⁰⁹*Ibid*, p. 15.

(iii) All levels of government and key private sector players should work cooperatively towards building trust in the electronic market place, and in particular, work together to establish clear policies in a number of technical areas.⁴¹⁰

The experience of various developed countries and international organisations, such as the OECD as well as the EU, provides a useful base for the developing countries. Experts have recommended that they should establish an advisory committee and prepare an ESD strategy as a first step. Whereas this is not inherently faulty, care should be taken to ensure that such countries do not fall into the False Paradigm Model problem and prescribe remedies that are not suitable for the particular jurisdiction. Indeed, this study is of the view that an ESD strategy can be formulated within the usual tax administration structure by the tax administration and therefore there would be no need for an advisory committee.⁴¹¹

There are some inherent risks for clients, government and officials that come with ESD. For taxpayers the risks include privacy due to the vulnerability of electronic systems to unwanted interference, security as a result of the possibility of the data available online being unlawfully used to the detriment of the taxpayer, cost implications in acquiring, using and maintaining the systems, equity between taxpayers and the burden of change. The risk for the government are risks to program delivery and continuity, increased costs from infrastructure overhead training and updating for technological change, and fraud and misuse. The risks for the officials include a changing work environment, changes in volumes of work and changes in skill needs. However, there are also potential risks in failing to innovate and therefore failing to introduce new systems.⁴¹²

There is the potential of reducing costs, improving efficiency, accessibility, transparency and client orientation when ESD is used, while simultaneously being an effective training and public relations tool. This ensures that on the one hand the tax

⁴¹⁰*Ibid*.

⁴¹¹*Ibid*, p. 17.

⁴¹²*Ibid*.

administrator's work is simplified and on the other the taxpayer is facilitated. It also makes the taxpayer feel involved in the process which may lead to enhanced collections. There are instances, however, that ESD is deemed by taxpayers to be burdensome leading to protests as will be seen later in this chapter. 413

It is clear that the automation of tax systems in Kenya is largely borrowed from other iurisdictions. The 'Simba 2005 system' has its origins in Senegal. 414 the Integrated Tax Management System (ITMS) was borrowed from Chile, 415 and the Electronic Tax Register (ETR) was implemented as a result of study visits to Italy, Greece and Turkev.416

As will be seen later, imposing new IT systems without altering the underlying business processes of the tax administration, or without establishing sufficient links to information providers within and outside the public sector, and providing adequate staffing infrastructure, is a recipe for failure. 417

5.2 IMPLEMENTATION OF ELECTRONIC AND AUTOMATED SYSTEMS IN **KENYA**

As noted in Part 1.1.1 herein, the use of computers and the establishment of effective database management systems in tax administration was an objective of the Tax Modernization Programme of 1986. The overall objective of the modernization programme was enlarging the revenue base. As such, the implementation of electronic and automated systems should be seen in that light.

From inception in 1995 up to 2003, KRA did not achieve recognizable reforms in automation. A planned computerization project had stalled due to lack of funding. KRA, however, still appreciated the need for effective use of automated systems to

⁴¹³*Ibid*, p. 19.

⁴¹⁴KRA (2010) *supra*, p. 61.

⁴¹⁵*Ibid*, p. 123.

⁴¹⁶*Ibid*, p. 85.

⁴¹⁷Dhillon, A. and J. J. Bouwer (2005) "Reform of Tax Administration in Developing Nations", generally.

collect, collate and share information using reliable databases and a common identification number.⁴¹⁸

The successful introduction in Kenya of new technologies required the consideration of the susceptibilities of existing staff and their resistance to change. The human element in the adoption and implementation of technology is critical. 419

Arising from the Economic Recovery Strategy (ERS) Paper, 420 KRA launched a "New Generation Reforms" programme referred to as Revenue Administration Reforms and Mobilization Programme (RARMP) with a view to implementing comprehensive tax reforms. It had seven projects, among them, business automation. It had the intention of developing an ICT strategy to promote integration and provide a single window view of a taxpayer. 422

Adopting ICT and modern business systems has been acknowledged as the means to give KRA capacity to receive access and process data in a seamless and integrated manner. This is with a view to providing efficient services thereby achieving high levels of taxpayer compliance.⁴²³

KRA developed an ICT strategy articulating the roadmap towards business automation and integrated business architecture. This would provide service to both internal and external stakeholders thereby enabling single view of the taxpayer across all KRA functions. The initiative, under business process automation, includes customs system; integrated Tax Management System, Vehicle Management

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⁴¹⁸KRA (2010) *supra*, pp. 37-39.

⁴¹⁹Bird, R. M. and E. M. Zolt (2008) *supra*, p. 11. This information was largely borrowed from Peterson, S. B. (1996) "Making IT Work: Implementing Effective Financial Information Systems in Bureaucracies of Developing Countries", in Jenkins, G. (ed) (1996) *Information Technology and Innovation in Tax Administration*, Kluwer Law International, the Hague, pp. 177 - 94.

⁴²⁰Kenya, Government of (2003) Economic Recovery Strategy (ERS) for wealth and employment creation.

⁴²¹RARMP was intended to transform KRA into a modern and fully integrated revenue administration agency by 2008/09.

⁴²²KRA (2010) *supra*, pp. 40-45.

⁴²³*Ibid*, p. 56.

System, Enterprise Resource Planning System, Data Warehousing and Revenue Portal, Disaster Recovery and Business Continuity Plan, improvement of ICT infrastructure, enhancement of IT security, Common cash Receipting System, Performance Dashboard and e-learning systems. 424

KRA launched its website in 2000, initially www.kra.go.ke and later www.kra.go.ke. It is used to provide several online services. 425

The services available through the KRA portal include online filing of returns, monthly VAT (VAT 3), withholding tax (VAT 32), individual income tax (IT 1), PAYE, corporation tax (IT2C), and sugar development levy (SDL). Simba 2005 System has also been enhanced.⁴²⁶

Herebelow we address three main automation systems implemented by KRA to assist in tax administration. These are the Integrated Tax Management System, the Simba 2005 System and the Electronic Tax Register.

5.2.1 Integrated Tax Management System (ITMS)

The ITMS project commenced in 2007. It entailed using the Chile Tax System⁴²⁷ as the basis of developing Kenya's integrated tax management system. This was done under a country to country co-operation arrangement.⁴²⁸

The major ITMS components are "electronic tax registration, e-tax filing (all returns and attachments), e-tax payment, e-tax statement enquiries, a web – based question and answer page, and a facility to send email. These would appear to be ordinary functions of an IT system that can be developed specifically for KRA without having to adopt another country's system.⁴²⁹

⁴²⁵*Ibid*, p. 57.

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⁴²⁴*Ibid*, p. 57.

⁴²⁶KRA (2012) *supra*, p. 13.

⁴²⁷KRA had also reviewed other systems including those of New Zealand, Ireland and Netherlands.

⁴²⁸KRA (2010) *supra*, p.122 – 123.

⁴²⁹*Ibid*, p. 124.

Due to inadequate training of staff in the technical aspects of ITMS, it has not achieved optimum implementation. This is indicative of poor preparation for the system.⁴³⁰

KRA has now (effective 2013) introduced iTax or e-pay through a Common Cash Receipting System (CCRS). This is a web-based system that enables taxpayers to file returns online, and more importantly, make payments online for customers whose banks support the system.

iTax is an online platform that enables one to register, file tax returns, process payments and make status enquiries in real-time. Commercial banks are integrated into the system, and a service level agreement entered into to govern the relationship. KRA also intends to partner with other intermediary agents including accountants and lawyers who would be enabled to transact on iTax.⁴³¹

According to KRA, iTax is an improvement on ITMS which did not succeed in automation of taxation and led to customer dissatisfaction. This is because of the 'inefficiencies and bureaucratic systems' associated with ITMS.⁴³²

The iTax appears to be getting into the same challenges that met ITMS. Whereas it was launched on October 22, 2011, KRA has been unable to fully and effectively roll-out the system. It is now looking at a phased approach to the roll-out blaming technical hitches on the failure of mass implementation. It is expected to reduce the cost of compliance, and with a view to removing opportunities of corruption it is supposed to reduce interaction between taxpayers and KRA staff. However, training on the use of the system is still inadequate. 433

⁴³⁰KRA (2010) *supra*, p. 20.

⁴³¹Daily Nation, October 24, 2013, Advertising Feature on 'Integrated Tax Management System (iTax)', p. I.

⁴³²Ibid, p. VI.

⁴³³ Daily Nation, September 2, 2014, "KRA postpones roll-out of iTax to March 2015," p. 38.

5.2.2 Simba 2005 System (S2005S)

A stable automated IT system is a central pillar of a reliable customs administration as it would facilitate rapid cargo clearance and electronic exchange of data. Prior to 2005, the customs department used an IT system known as BOFFIN. This was noted to be cumbersome to traders. Indeed, various IMF Fiscal Advisory Division consultancy reports cited it as an impediment to trade. 434

The Simba 2005 system was initiated in 2005. It is an internet – based customs IT system that came into being after the acquisition and customization of GAINDE 2000 used by the Senegalese customs department. This was on the recommendation of the World Bank. Without belabouring the point, this is indicative of the influence foreign "experts" have on tax administration reforms in Kenya. It is not clear why the World Bank felt that the Senegalese system was ideal for the Kenyan situation.

The system enabled the automation of approximately 90 percent of Customs operations. It dispensed with the need for traders to physically visit KRA. Traders can remotely lodge entries electronically as long as they have internet access and pay customs duty directly through local commercial banks.⁴³⁷

The system introduced online lodging of manifests and entries, electronic processing, automated reports and reconciliations, electronic presentation of customs entries, automated calculations of duties and taxes and internal accounting. By its very nature, the system provides audit trails and eliminates many human interventions. This reduces the possibility of error or inappropriate practices, such as rent–seeking.⁴³⁸

⁴³⁴KRA (2010) *supra*, p.60.

⁴³⁵ Other systems that had been studied were those in use in Singapore, Mauritius, Philippines and Zambia.

⁴³⁶KRA (2010) *supra*, pp. 60 – 61.The then World Bank Country Representative, Mohktar Diop, proposed it to the then Commissioner – General, M.G. Waweru, in a meeting in May 2004.

⁴³⁷ KRA (2010) *supra*, p. 61.

⁴³⁸*Ibid*.

Customs revenue rose from Kshs. 96 billion in 2003/04 to Kshs. 179 billion in 2008/09. In the financial year 2005/06 the computerization of customs service resulted in lower import duties and VAT on imports and consequently revenue targets were not attained. The overall impact of the system had not been satisfactorily assessed and as such measures to mitigate such risks had not been taken.

The introduction of S2005S was strongly resisted by traders. This was especially because it came to light that some imported motor vehicles had not been taken through the system due to collusion between importers and customs officials. This is indicative of the fact that other factors such as quality of personnel, integrity and patriotism ought to be considered.⁴⁴¹

The full implementation of this system was hampered by lack of adequate training of staff in the technical aspects.⁴⁴² It also suffers from IT security integrity and as such it is still not free from intrusion by unauthorized users.⁴⁴³

The Simba 2005 system continues to experience challenges related to system performance, system security, system unavailability and unreliability. There is therefore need to upgrade the application software.⁴⁴⁴ It is interesting to note that an upgrade is proposed even before full implementation.

The upgrade programme of the Simba system began in earnest in 2013 with financing from Trademark East Africa, a British firm. This is towards alleviation of the problems associated with the system.⁴⁴⁵

⁴³⁹*Ibid*, p. 62.

⁴⁴⁰ Kenya, Republic of (2007) Kenya Vision 2030, p.3.

⁴⁴¹ Moyi, E. & E. Ronge (2006) Taxation and Tax modernization in Kenya: A Diagnosis of Performance and Options for Further Reform, p. 5.

⁴⁴²KRA (2012) supra, p. 20.

⁴⁴³*Ibid*, p. 38.

⁴⁴⁴*Ibid*, p. 62.

⁴⁴⁵Ayaga, W. "Trademark injects Sh. 1.1 billion for simba system upgrade," *The Standard*, Friday, September 20, 2013, p. 61.

5.2.3 Electronic Tax Register

The ETR system was introduced in 2005 as a tool to address the perennial problem of poor record keeping for business transactions.⁴⁴⁶ It is used for the administration of the Value Added Tax (VAT), which relies heavily on proper recording of transactions.⁴⁴⁷

The ETR creates a clear invoice trail and it is therefore easier to detect and deter tax evasion. Prior to its introduction, there were many cases of maintaining parallel books of account for VAT and business records.⁴⁴⁸

The introduction of the ETR was met with open resistance through strikes and street demonstrations. The major complaints were that taxpayers were required to incur costs in purchasing the ETR machines and the fact that the obligation of maintaining the machines is borne by the taxpayers. Adequate consultation had not been undertaken.⁴⁴⁹

The ETR system was introduced after study visits to Italy, Greece and Turkey. The system had also been implemented in Italy, Greece, Poland, Brazil, Argentina, Venezuela, Ukraine, Bulgaria, Yugoslavia, Russia, Romania, Cyprus, Malta, Hungary, Czech Republic, Latvia, Lithuania, Turkey, European Union, Germany and Sweden. 450

The main objective of the system was to enhance revenue by enforcing improved and secure receipting and record keeping methodologies. This in effect shifted the burden of compliance to the taxpayer, albeit through the use of a machine.⁴⁵¹

⁴⁴⁶KRA (2010) *supra*, p. 85.

⁴⁴⁷*Ibid*.

⁴⁴⁸*Ibid*.

⁴⁴⁹ Moyi, E. & E. Ronge (2006) *supra*, p. 5.

⁴⁵⁰KRA (2010), Supra, p. 85.

⁴⁵¹*Ibid*.

The advantages of an ETR system have been cited as follows:

- a) Better control/management of business by traders.
- b) Improved record keeping by traders.
- c) Reduced tax audit period and paper work on taxpayers and tax auditors
- d) Less paper work by traders.
- e) Reduced disputes and court cases.
- f) Reduced fraudulent accounting and improved VAT revenue.
- g) More jobs for local technicians and software houses; and
- h) Minimized cost of records by taxpayers, since daily, monthly and annual reports are automatically generated by ETR.⁴⁵²

Between July 2005 and May 2008, a total of 38,400 taxpayers installed 55,200 ETR devices. This was 75% of the targeted taxpayers. Whereas the percentage looks impressive, regard must be taken of the period within which this was done (3 years) and the total number of taxpayers involved. The number of taxpayers was clearly a small fraction of the total number of taxpayers in the country.

The ETR system enhanced compliance and VAT revenue collections, which increased by 24 percent from Kshs. 42 billion to Kshs. 52 billion between 2004/05 and 2005/06.⁴⁵⁴

The implementation of the ETR system has not been without challenges. These have taken the form of litigation, hostility and a negative attitude from sections of the business community, enforcement, pricing of ETR devices, the capacity of suppliers to handle technical challenges arising after installation and integrity issues.⁴⁵⁵

Additional challenges continue to manifest themselves. These include non-usage of ETR machines by some taxpayers (especially after official working hours and weekends), inadequate staffing to enforce ETR compliance, poor management and

⁴⁵³*Ibid*, p. 85.

⁴⁵²*Ibid*, p. 86.

⁴⁵⁴*Ibid*, p. 86.

⁴⁵⁵*Ibid*.

control of ETR field staff, reactive rather than proactive enforcement procedures, frequent breakdowns and late reporting of the same by taxpayers and increased paperwork, given the need to submit monthly print–outs on ETR sales (the Z-reports). The system still relies on enforcement by officers of KRA and/or goodwill on the part of taxpayers. Without remote connection with other KRA systems, it still doesn't satisfactorily address the problem it was meant to.⁴⁵⁶

The remedial measures used by KRA include prosecution of offenders, compliance checks and compounding of offences, sensitization/publicity campaigns and reevaluation of ETR suppliers. However, the long term strategy to deal with the challenges is to network ETR devices and ITMS to facilitate seamless exchange of information. 457

ETR is an underperforming programme. KRA intends to overhaul the system with a view to providing electronic linkage between the ETRs and ITMS. This would then allow for "automated population of taxpayer accounts and electronic monitoring of non-compliant taxpayers". 458

5.3 <u>DEVOLUTION OF ELECTRONIC AND AUTOMATED SYSTEMS TO</u> <u>COUNTIES AND OTHER SUBNATIONAL TERRITORIES</u>

Every modern tax administration is expected to employ automated systems for the major processes. These would include document receipt and management, issuance of notices, filling and imaging of documents and taxpayer services-related information sharing. This is the inevitable reality of the technology age. 459

Lack of technological connectivity causes considerable lag in information sharing. Without modern technological systems, paper trails, physical transfer and photocopying of documents are likely to take most of the time and hence

⁴⁵⁶*Ibid*, p. 125.

⁴⁵⁷*Ibid*, pp. 86 and 125.

⁴⁵⁸KRA (2012) *supra*, p. 86.

⁴⁵⁹Gallagher, M. (2004) *supra*, p. 37.

uneconomical. Sometimes, data transfer may take the form of physical delivery of data disks and tapes. These would inevitably lead to error, untimely delivery of information and may leave loopholes that fraudulent taxpayers may exploit. They may also lead to unfair penalizing of compliant taxpayers.⁴⁶⁰

All county tax administrators should therefore ensure that they have reliable systems. These should include secure back—up systems. This is because county tax administrations cannot operate outside the modern modes of doing business.

The international benchmark for the use of automated systems for tax administrations are as follows:

- a) Use of automated systems for daily use.
- b) Interconnectivity between headquarters and local tax offices, and between local tax offices themselves.
- c) Backup systems for all uses.
- d) Operating taxpayer current account.
- e) Clean and operating taxpayer registry.
- f) Automated audit case selection.
- g) Tax declaration entry with automatic error correction.
- h) Use of exogenous information.
- i) Use of third party databases.
- i) Data crossing among taxes.
- k) Late or stop filers system.461

It has been noted in Estonia that software applications designed at the national level are often faulty or do not reflect the needs of local tax offices and need to be locally re-designed. This is an inevitable consequence of extending the use of technological applications to different areas without considering "cultural" differences. The

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⁴⁶⁰ Ibid.

 $^{^{461}}$ *Ibid*, pp. 27 – 28.

computer skills at the local level are also wanting and the many possibilities offered by the use of modern software cannot be exploited.⁴⁶²

The use of electronic and automated systems at the county level does not necessarily require the devolution or decentralization to the counties of the systems used by the national tax administration. It is important that systems that can work at the county level be identified after which they can then be synchronized with the national systems. This would avoid a situation whereby the systems are not adaptive to local realities and hence do not reflect the needs of the specific counties.

5.4 PRIMARY RESEARCH FINDINGS

The research design and methodology applied, including the sample size is described in Chapter 1.

5.4.1 Findings from KRA Officers

Most respondents in this category felt that the electronic and automated systems have served KRA and taxpayers well. KRA is now working on upgrading them. The initial challenge with all the systems was acceptability. This is because most taxpayers had not embraced the benefits of information technology but now with the widespread penetration of IT, taxpayers have greatly appreciated the use of technology. However, there is the challenge of electronic fraud or cyber crime.

The respondents are generally of the view that ETRs have worked well and enhanced collection of VAT. The main challenge to ETRs has been abuse in the sense that some taxpayers do not use them for all their transactions and therefore fail to issue fiscal receipts for some transactions as well as failing to maintain fiscal data. In such cases, KRA loses revenue. KRA is now upgrading the ETR system by linking ETRs to GPRS so that the transactions of taxpayers are monitored and data relayed in real time to KRA. When this is done, KRA will know in case of failure to

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⁴⁶²Sootla,G., K. Kasemets and S. Kunnapuu (2001). "Local and Regional Tax Administration in Estonia," in *Local and Regional Tax Administration in Transition Countries*, P. 177.

use an ETR and immediate action will be taken. This will greatly increase VAT compliance.

ETR has not been adopted by all businesses and as such not everything is captured. The ETR does not have location-determining features and as such some traders cannot be reached at their locations. It also does not have linkages with other KRA systems for audit and verification purposes. It does not relay real-time data to KRA. The register may also be tampered with or it may even break down. It was not easy to implement ETR due to objections and protests from taxpayers. Some traders are not ready to comply and perform sales without issuing ETR receipts or even issue counterfeit receipts.

The Simba System has worked well. It increased tax revenue since it removed face to face interactions with taxpayers thereby increasing tax compliance. It is being upgraded to enhance its compatibility with the latest IT platforms and integration with other tax systems. The upgrade once completed is expected to greatly increase compliance even in domestic taxes since taxes on imports could still be linked to taxes on final output. The respondents consider it an effective system.

S2005S had problems during implementation, some of which persist to date. The system either stalls occasionally or has long connectivity downtimes. It can also be tampered with. Its effectiveness is also affected when changes made through the budget process are not updated in the system in good time. It also faced opposition from clearing agents who thought it would put them out of business.

The ITMS, now called iTax, is an upgraded system that allows a single view of the taxpayer. It allows taxpayers to make online returns and payments. The previous systems were disjointed and cumbersome for taxpayers to file their returns. The iTax has therefore resolved these weaknesses and provided an avenue for online registration, filing, reporting and payment of taxes.

The ITMS is not a very friendly system to use. It operates online and therefore has the tendency of causing heavy traffic inevitably leading to internet downtime. It could not integrate the various transactions from taxpayers with the other systems and was not tamper-proof. It occasionally made system errors. In a country where many taxpayers are computer illiterate, or semi-literate, its impact may not be easy to appreciate especially because KRA does not have the capacity to educate all taxpayers.

The iTax implementation is at its initial stages. It will enable the taxpayer to maintain a personal profile of his tax matters. It is encountering teething problems and some resistance from taxpayers.

KRA is currently implementing an electronic system to increase compliance with regard to domestic excise tax. This involves electronic monitoring of the flow meters for excise tax as well as enhanced security features for excise stamps to curb fraud.

KRA has also introduced the Payment Gateway system. This is a system that will allow for the electronic payments to be made possible through the integration with commercial banks and KRA business systems. This will be beneficial to taxpayers since it will allow for real time capture of payment transactions to enhance compliance processes in KRA. The payment gateway will be beneficial to KRA for easier and faster reconciliation of payment data. At the moment, 20 banks have gone live on the system and 3 others have passed user acceptance testing and are under pilot.

Another system that is under implementation by KRA is the Data Warehouse and Business Intelligence (DWBI). This is aimed at interfacing KRA systems with strategic external sources for information exchange purposes, taxpayer recruitment, data matching and risk profiling and to validate tax returns. To facilitate this, KRA needs to implement an appropriate DWBI solution that will enable profiling information and to provide a single view of the taxpayers. Currently, a project implementation team has been set up and KRA is in the process of negotiating for project funding.

5.4.2 Findings from Taxpayers

Opinion was divided at 50% between the respondents on whether ETR is an effective tool of collection of VAT. Those who said that it is effective further had caveats to the effect that it is prone to abuse, should be real-time and should be closely monitored.

Several challenges in implementing ETR were also identified. These include challenges in understanding its use; the initial cost outlay especially to small businesses which does not add value to businesses but convenient only to the tax authority; unreliable machines which are difficult to use; some taxpayers failing to give ETR records and the failure by KRA to conduct adequate stakeholder education.

The respondents suggested ways through which collection of VAT would be made more effective. These include the use of simple computation methods; use of online filing system; tough enforcement measures; widening scope of VAT tax base; taxpayer education; increasing staffing levels at KRA; technical training for taxpayers and tax collectors; improving remuneration for revenue authority staff; automation of entire VAT system; reduce local zero rated items and the citizens should see the revenue being put to good use to motivate them to comply.

The respondents generally felt that S2005S is an efficient system. They, however, highlighted the challenges. These include frequent system outages; users not well oriented; unreliability and low internet connectivity speed; and the failure of the system to work sometimes due to human interference motivated by vested interests.

The ways through which collection of customs duty can be made more efficient were identified as making computation easy; recognition of more tax compliant taxpayers through granting of Authorised Economic Operator (AEO) status through which a taxpayer need not have their goods verified to the full extent but instead rely on provided documentation; and, reduce the human interfaces and let systems and processes work.

5.4.3 Findings from Tax Professionals

ETR has to a great extent addressed revenue leakage from a VAT perspective and to a greater extent the income tax as well. The Z reports that are details of transactions undertaken during a particular period are accessible to KRA, who can then cross check whether the data contained therein is correct vis-à-vis the VAT 3 returns filed and Self-Assessment Return (SAR) at the end of the year.

Further, by virtue of the fact that payment of an invoice without VAT leads to the payer being penalized (VAT claimed is not available for offset), then, doing business has put a demand to have invoices accompanied a valid ETR print out. To that extent, ETRs have been effective.

In respect to the Simba System, Customs clearance of goods in the East African Community (EAC) involves self-declaration to the customs authorities of the items being imported, their value and country of origin among other data requirements. Increasingly across the globe, this declaration is made using automated systems for the efficient importation or exportation of goods as well as compilation of accurate trade statistics.

The EAC is working to improve the level of automation and electronic systems used for customs clearance, which currently vary among member countries. This customs modernization initiative promotes the implementation of an electronic single window operation. Under the electronic single window, both the revenue authorities and other regulatory bodies involved in customs clearance approve importations using one platform.

The Common Market for Eastern and Southern Africa (COMESA) adopted the Automated System for Customs Data (ASYCUDA) as the official customs system. This system has been updated with different versions over time.

Within the EAC region, Uganda, Tanzania, Rwanda and Burundi currently use the version, ASYCUDA++ whereas Kenya uses the SIMBA System. ASYCUDA++ is not fully automated and involves extensive paper work and use of manual systems. At times, the system does not generate all required reports. Such inefficiencies necessitate an upgrade of the system to ASYCUDA World, which is web based and offers full time online access to customs services. It is basically based on an electronic single window operation.

ITMS has seen a great move from the initial manual based compliance and filing of the tax information to technology based tax administration. Though initially piloted for some taxes and some taxpayers, it has significantly reduced the costs incurred in queues to file returns and filing system. Some of the areas that it has been used in are PIN registration, VAT filing, PAYE filing and some Corporate Income tax filing. The major challenge with this system was however the accessibility challenges – slow system and inability to verify the data filed online.

ITMS has since been replaced with the iTax system that is meant to improve it. iTax is an integrated, web enabled and secure application. It provides an automated solution for administration of domestic taxes aimed at improving compliance and reduce cases of tax evasion. For instance, under iTax, a taxpayer submitting withholding tax certificates as part of tax return filing can actually verify whether the withholding tax was indeed paid. This will also be the case where an employee can verify whether the taxes withheld from his/her emoluments have been remitted to the tax authority.

5.5 CONCLUSION

This study has observed that whereas changes in technology may influence tax administration, it cannot be a solution to all taxation problems but just part of the answer. There is therefore need to reform the basic tax law and the administrative structures before resorting to gadgetry.

The impact of electronic commerce cannot be gainsaid. This must therefore be addressed in the same breath as the computerization of tax administration.

A modern tax administration must keep up with computerization in the major sectors. As such, the tax administration must computerize. Computerization of a tax administration must be done in tandem with other key tax administration procedures. When inadequate procedures are computerized the intended objective may not be achieved.

The tax administration must be appraised so as to determine the systems that would enhance it. This study notes that tax administrations should design and implement computer systems with a degree of autonomy to ensure that they fit into the circumstances obtaining within the jurisdiction.

With the advent of electronic commerce, governments should create a favourable tax and regulatory environment. The computer system adopted by the tax administration should have capacity to link with the channels of electronic commerce.

The findings of this study are that most of the computer systems introduced by KRA are largely borrowed from other jurisdictions. These range from Senegal (S2005S), Chile (ITMS) and Italy, Greece and Turkey (ETR). The ITMS, S2005S and ETR have had mixed fortunes. They have encountered challenges mainly due to resistance. They have also not been well adapted to local situations. The inadequacy of technical training of staff has also been cited as a constraint. There has also been external resistance to technology. The False Paradigm Model should be avoided when implementing new systems by first studying and understanding the local circumstances.

Introduction of new technologies requires due consideration of the human element. This is because of the susceptibilities of existing staff and their resistance to change. Systems that would reduce the human interface are likely to attract more resistance as they would reduce the opportunities of engaging in corrupt practices. Indeed in the implementation of new technologies the assumption should be that taxpayers

and tax collectors are less rational and therefore there should be mechanisms to ensure compliance and reduce discretion.

In addition to enhancing the capacity to receive access and process data, some automated systems would enable a single view window of the taxpayer. These would be ideal but the diverse harvest of taxes administered by diverse taxing authorities may not make that always possible.

The electronic and automation systems used by KRA are usually set for upgrades and improvement even before full implementation. This is because their full application in local conditions had not been considered before application.

It is important to note that for such systems to achieve the desired results, they must be applicable to the local conditions. Further, the tax agency staff must be involved in the entire implementation process to avoid possibility of resistance to change.

The use of electronic and automated systems attempt to reduce the discretion of tax officials to the minimum. In that respect, these reforms are in line with the rule of robustness. However, the systems introduced in Kenya have not performed well when measured against the rule of results and the rule of relevance.

County tax administrations have to use technology. These systems should be reliable and have back-ups. They should be designed for the local conditions. The systems used at the county level should have the capacity to be synchronized with the systems used by the national tax administration to facilitate information sharing and exchange.

Having addressed the major tax administration reforms undertaken at the national level in the last three Chapters, the following Chapter addresses county taxes and their administration.

CHAPTER 6

COUNTY TAXES AND TAX ADMINISTRATION

6.1. INTRODUCTION

County taxes are those taxes that counties are authorised to levy. As noted earlier, Article 209(3) of the Constitution of Kenya, 2010, provides that the only taxes that a county may impose are property rates, entertainment taxes, and any other tax that it is authorized to impose by an Act of Parliament. 463

As seen in Chapter 2, counties are the subnational units of devolution in Kenya. Whereas they are distinct, they have an interdependent and mutual relationship both between themselves and with the national government. The system of devolution succeeded a system of de-concentration where the decentralized units were local authorities. Counties are expected to take development closer to the people. The rationale of giving counties revenue-raising powers is to give them fiscal capacities and stability to enable them discharge their duties effectively.

Local or subnational taxes have a large distortionary effect on resource allocation decisions and may also provide disincentives for businesses. To address that concern this study proposes in Chapter 7 that mechanisms should be established to ensure that tax policies in counties do not have a negative effect on businesses across county boundaries. They are also subject to corruption and mismanagement. Some commentators consider them to be complicated and that they are costly to administer due to their non-transparent making process. This, as will be seen later in this Chapter, is not entirely true as the principal subnational tax in most jurisdictions is property tax which is generally considered as the ideal tax for subnational administration.⁴⁶⁴

⁴⁶³It is noteworthy that the Constitution uses the term 'rates' as opposed to taxes. The effect of choice of word will become evident later.

⁴⁶⁴ Moyi, E. & E. Ronge (2006) *supra*, p. 32.

6.2 PROPERTY RATES

6.2.1 Introduction

The Constitution of Kenya, 2010, does not define property rates. It, however, defines property to include any vested or contingent right to, interest in or arising from land, or permanent fixtures on or improvements to, land; goods or personal property; intellectual property; or money, choses in action or negotiable instruments. 465 The effect of this is that counties would have the power to impose taxes on these types of property. This would mean that they can impose taxes on land and buildings, movable goods, trademarks, patents and copyright, money and negotiable instruments. If this was to be done, then it would mean that counties may encroach on taxes that can only be imposed by the national government under Article 209(1).

However, the thesis herein is that the foregoing was not the intention of the drafters of the Constitution as it would lead to absurdity. 466 This would explain the choice of the term 'property rates' as opposed to 'property taxes'. This would in effect attach the tax on real property only. This is because the term rates would not refer to a tax on the other types of property, for instance, movable goods. 467 The unified approach to statutory interpretation supports this interpretation.⁴⁶⁸ The Interpretation and

⁴⁶⁵Article 260.

⁴⁶⁶ This is dealt with in greater details later in this Chapter.

⁴⁶⁷ Indeed property tax has been defined to refer to a recurrent tax imposed by a government on the ownership and/or occupation of property whereby property would refer to both movable and immovable property and tangible and intangible property. For this description, see Monkam, N. F. (2010) Mobilising Tax Revenue to Finance Development: The Case for Property Taxation in Francophone Africa, Working Paper 195 (November), p. 2. 468 The Unified Contextual Approach to statutory interpretation was set out by Sir Rupert Cross as follows:

[&]quot;1. The judge must give effect to the grammatical and ordinary or, where appropriate, the technical meaning of words in the general context of the statute; he must also determine the extent of general words with reference to that context.

^{2.} If the judge considers that the application of the words in their grammatical and ordinary sense would produce a result which is contrary to the purpose of the statute, he may apply them in any secondary meaning which they are capable of bearing.

^{3.} The judge may read in words which he considers to be necessarily implied by words which are already in the statute and he has a limited power to add to, alter or ignore statutory words in order to

General Provisions Act⁴⁶⁹ does not apply to the construction or interpretation of provisions of the Constitution and therefore would not be of use to define this.⁴⁷⁰

The position taken in this study is based on the fact that in Kenya, historically, traditionally and conceptually, the term 'rates' is used to refer to the tax imposed by the now defunct local authorities on real property within what was their jurisdictions.⁴⁷¹ Any other meaning would require new jurisprudence. Indeed, rates have been defined as a form of property tax imposed on land by a local authority.⁴⁷²

There is a clear distinction, however, between property rates and other property-related taxes. Property rates refer to the annual tax on immovable property levied on the owner or occupier, mainly by the local government. Other taxes are levied on the income from property, or the use, the acquisition or alienation of such property. These range from income tax, VAT, land rent to stamp duty.⁴⁷³

The concept of property has been evolving over time, and with it, the importance of the various categories of property. This is why there would have been need to harmonise Articles 209 and 260 of the Constitution of Kenya.

Property taxes are generally levied on all types of properties including residential, commercial, and industrial and farm properties.⁴⁷⁴ For instance, property tax in the United States was originally a tax on all forms of property. This included real and

prevent a provision from being unintelligible or absurd or totally unreasonable, unworkable, or totally irreconcilable with the rest of the statute.

4. In applying the above rules the judge may resort to certain aids to construction and presumptions..." (Bailey, S. H., J. Ching, M. J. Gunn & D. Ormerod (2002) *Smith, Bailey and Gunn on The Modern English Legal System* (4th edition), Sweet & Maxwell, London, p. 417).

⁴⁷⁰ Section 2.

⁴⁶⁹ Cap. 2.

⁴⁷¹ See the Local Government Act (Cap. 265) (repealed), the Valuation for Rating Act (Cap. 266) and the Rating Act (Cap. 267).

⁴⁷²Rihal, B.S (2004) *Land Rating Handbook*, Konrad Adenauer Foundation, Nairobi, p.18. See also Franzsen, R. C. D. (2002) "Property Assessment for Rating Purposes in Southern and East Africa: Present Status and Future Prospects," p. 2.

⁴⁷³ Franzsen, R. C. D. (2002) *supra*, pp. 2-3.

⁴⁷⁴ Bird, R. M. & E. Slack (2002) "Land and Property Taxation: A Review," p. 12.

personal, tangible and intangible, "upon every man according to his estate, and with consideration to all his other abilities whatsoever". This has been observed as suited for an agrarian economy and not the modern economy where the economic structure has shifted to new forms of wealth and property. Consequently, the most common form of property tax in the US today is an annual ad valorem levy on land and buildings. 475

Real property tax has been noted to be the most appropriate revenue source for local governments and as such it is the most widespread form of local taxation. Whereas in some countries property tax revenues amount to up to 4 per cent of GDP, in developing countries the revenues only account for just 0.6 per cent of GDP. This means that whereas property tax should be an important revenue source for local government, it is underutilized in developing and transition countries. This is referred to as the fiscal paradox of property tax. 476

As will be seen in Table 1 herein, Kenya underutilizes its property tax capacity. The property rates productivity has, for the most part, stagnated and declined in relation to other revenue sources and as a percentage of GDP. This has more to do with inefficient administration, with policy playing a marginal role. 477

Property tax has operated for centuries and is therefore regarded as an integral part of local government. Due to its visibility and stability, and the difficulties in its avoidance, it is considered to be an ideal base for local taxes. The stability enables the local government to make forecasts about its future income. Compared to other taxes, it is relatively easier to collect. It has the effect of enhancing the status of local governments when they collect it locally and also stimulates occupier interest in local governance. The owners are also encouraged to have fuller occupation of their

⁴⁷⁵ Youngman, J. & J. Malme (n.d) The Property Tax in a New Environment: Lessons from International Tax Reform Efforts, Lincoln Institute of Land Policy, Cambridge, Massachusetts, p. 7. The quote is from 1634 Massachusetts property tax statute as borrowed from Jens Jensen (1931) Property Taxation in the United States, p. 27.

⁴⁷⁶ Connolly, K. & M. Bell (2010) "Financing Urban Government in Transition Countries: Assessment, Uniformity and the Property Tax," p. 3. 477 Kelly, R. (2000) *supra*, p. 38.

properties so that they can get the best returns after payment of the tax. It is also generally believed that it is not excessive on the majority of the taxpayers.⁴⁷⁸

It has been observed that the major deterrent to the fuller utilization of property tax is the difficulty in its administration. This means that in most developing and transition countries, property tax is poorly administered.⁴⁷⁹

Property taxes are also often unpopular because by their very nature, there is an element of inherent arbitrariness in the process of assigning values to individual properties. It is not easy to scientifically ascribe value to properties without using estimates.⁴⁸⁰

The often stated rationale for property taxation is that it is both a source of local government revenue and its effect on efficient land use. In many countries, the level design and control of property taxation are critical elements in the decentralization policy.⁴⁸¹ The degree of local discretion in establishing the tax base and setting the rates determines the diversity in property taxes within the country.⁴⁸²

Property taxes are suitable for local governments (especially municipalities) for the reasons that they lead to automatic localization; they have a clear jurisdiction; they reflect the ability to pay; they are a steady revenue for local governments; their suitability for budget balancing; and, they are not regressive (that is, they are progressive). Whereas the other reasons may hold, they are not really a reflection on the ability to pay. A person may own land, say through inheritance, but he has no means to pay the tax demanded on such land.⁴⁸³

Bird & Slack identify some home truths about the role of property tax as a source of revenue. They consider taxes on land and property as minor revenue sources in all

⁴⁷⁸ Olowu, D. (2004) "Property Taxation and Democratic Decentralization in Developing Countries," *Working Paper Series No. 401*, p. 13.

⁴⁷⁹Connolly, K. & M. Bell (2010) "Financing Urban Government in Transition Countries: Assessment, Uniformity and the Property Tax," p. 3.

⁴⁸⁰ *Ibid*, p.4.

⁴⁸¹ Bird, R. M. & E. Slack (2002) *supra*, p. 2.

⁴⁸² *Ibid* n 3

⁴⁸³ Olowu, D. (2004) "Property Taxation and Democratic Decentralization in Developing Countries," *Working Paper Series No. 401*, pp. 11-12.

countries. They are, however, important sources of subnational revenue in many countries, moreso in developing countries. In the 1990s, property taxes accounted for 40% of all subnational taxes in developing countries. This has seen a relative decline in recent times. During the same period it accounted for 35% in the developed countries. 484

In Africa, property tax is seen as one of the few taxes that are progressive and administratively feasible. However, it still yields revenue below its potential. As mentioned earlier, the reason for this has been poor administration.⁴⁸⁵

In Kenya, the role of property tax as a source of revenue has been marginal as shown by the table below.

Table 1: Tax Collection by Tax Regime, 2009-2012

		2009/10	2010/11	2011/12	2012/13
Taxes on income, profits and					
capital gains	Ksh. bn	219.5	272.3	329.9	403.6
Taxes on property	66	0.3	0.4	0.6	0.7
Value Added Tax (VAT)	"	142.0	171.9	177.8	231.9
Taxes on other goods and services	"	99.3	108.7	108.8	120.6
Excise taxes	44	74.1	80.6	80.3	91.9
Custom duties	66	57.2	66.7	77.9	98.8
Non-tax revenue	и	19.3	24.7	31.1	48.7

Source: Kenya Facts and Figures 2013, Kenya National Bureau of statistics⁴⁸⁶

The role of real property taxation in an era of globalization has been questioned. It has been argued that its role should actually be expanded. Its tax base cannot be shifted to another jurisdiction unlike other activities which cross borders with ease. Further, in an era of tax harmonization, local fiscal autonomy can only be secured by

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⁴⁸⁴ Bird, R. M. & E. Slack (2002) *supra*, p. 5.

⁴⁸⁵ ADB (2010) *supra*, p. 5.

⁴⁸⁶ www.knbs.or.ke

a purely local revenue such as property tax. The renewed attention to devolution and subsidiarity also require stable local revenue sources.⁴⁸⁷

Property tax reforms are important in developing countries for various reasons. These include:

- a. The tax is under-explored and under-exploited:
- b. The tax provides opportunities for strengthening local governments without eating into central government finances;
- c. The tax assists in meeting the shortfall on the reduction of central government transfers to local governments due to economic readjustments;
- d. The tax is inherently progressive rather than regressive, especially because of the progressively graduated tax rates, exemption of low value properties, higher than average tax rates on vacant plots or commercial properties, lower tax rates on improvement than on site value and better than average collection efforts for high value properties;
- e. Using the tax enables national government grants and transfer funds to be used for less wealthy and rural localities to avoid situations where urban regions are 'parasitic' on their respective rural economies;
- f. In the absence of property tax, local governments would be dangerously dependent on national government transfers which are not always reliable, buoyant or paid regularly. This would actually be an affront to the rationale for devolution.⁴⁸⁸

The major issues related to property taxation in Kenya and other developing countries are valuation, assessment and collection. Further, due to lack of complete cadastral data, identification of the property and the owner compounds the problem. Accordingly, property tax reform in Kenya is related to land reform. 489

⁴⁸⁹ *Ibid*, p. 22.

⁴⁸⁷Youngman, J. & J. Malme (n.d) *supra*, p. 3.

⁴⁸⁸ Olowu, D. (2004) *supra*, pp. 13-14.

6.2.2. Administration of Property Taxes

Real property taxes are deemed to be good for administration by subnational governments. It is easily administrable at that level. This is due to the nature of real property as visible, immobile and a clear indicator of one form of wealth. It is not possible to shift location in response to the tax due to its nature. Property tax is therefore difficult to avoid. 490

Property tax is a very visible tax and this is quite desirable as it makes taxpayers aware of the costs of local public services and enhances accountability. As a result, it becomes quite unpopular.⁴⁹¹

The property tax base is relatively inelastic and does not automatically increase over time. As such, there is need to increase the rate of tax from time to time. Inelasticity leads to greater accountability but at the same time leads to greater taxpayer resistance.⁴⁹²

Property tax is based on stocks i.e. asset values. ⁴⁹³ The value has to be determined. It has been observed that valuation is inherently and inevitably an arguable matter. Where the system requires a "self-assessment", owners are likely to undervalue their property and where there is an "official" cadastral assessment system, owners are likely to feel that their property has been overvalued. ⁴⁹⁴ Property valuation and assessment is not an exact science. ⁴⁹⁵

Property taxes act as a main support to local autonomy. An essential element of responsible local autonomy is that tax rates be set locally. This should be the responsibility of the county governments.⁴⁹⁶

⁴⁹⁰Mikesell, J. L (2003) *supra*, p. 22. See also Bird, R. M. & E. Slack (2002) *supra*, p. 8.

⁴⁹¹ Bird, R. M. & E. Slack (2002) *supra*, p. 10.

⁴⁹² *Ibid*, pp. 10-11.

⁴⁹³ This is to contrast it with most of the other taxes that are based on flows (income or sales). When a tax is based on flows, there is a measurable economic activity on the basis of which the tax is levied.

⁴⁹⁴ Bird, R. M. & E. Slack (2002) *supra*, p. 11.

⁴⁹⁵ McCluskey, W. J., F. A. S. Plimmer & O. P. Connellan (2004) "Property Tax Banding: A Solution for Developing Countries," p. 12.

⁴⁹⁶ Bird, R. M. & E. Slack (2002) *supra*, p. 11.

When the defunct local authorities administered property rates, they were responsible for maintaining property and ownership records, determining taxable property values, calculating and distributing property bills, managing receipt of payment and applying tax enforcement actions against non-payers.⁴⁹⁷

It is noteworthy that the National Land Commission Act, 498 whose object, among others, as laid out in its preamble is to give effect to the objects and principles of devolved government in land management and administration, allocates to the National Land Commission the function of assessing tax on land. 499 This would deny the counties the power to assess taxes they administer. This borders on unconstitutionality as it limits a power granted under the Constitution. However, Section 5(1)(g) borrows verbatim from the provisions of Article 67(2)(g) of the Constitution. The position of this study is that this refers to taxes other than property rates. There is need to clarify this in the Constitution.

To determine the success of property tax administration, governments usually use the Property Tax/GDP ratio. However, it has been observed that a more meaningful comparison would be to compare property tax collections with (estimated) market values. The ratio is referred to as the Effective Rate of Property Tax (ERPT). Thus,

EPRT=TC/MV

Where ERPT=effective rate of property tax

TC=taxes collected

MV=market values.500

"Pursuant to Article 67(2) of the Constitution, the functions of the Commission shall be-

. . . .

⁴⁹⁷Mikesell, J. L. (2003) *supra*, p. 22. This is largely borrowed from Eckert, J.K (Ed) (1990) *Property Appraisal* and Assessment Administration, International Association of Assessing officers, Chicago.

⁴⁹⁸ Act No. 5 of 2012.

⁴⁹⁹ Section 5(1) provides:

⁽b) to recommend a national land policy to the national government,

⁽g) to assess tax on land and premiums on immovable property in any area designated by law; and

⁽h) to monitor and have oversight responsibilities over land use planning throughout the country."

⁵⁰⁰ Bird, R. M. & E. Slack (2002) *supra*, pp. 5-6.

Little information is available on effective rates in developing countries. However, effective tax rates are generally low, moreso in developing countries. Many administrative factors play a role in this.⁵⁰¹

The key steps in the process of taxing real property are identification of the properties being taxed; preparation of a tax roll and responding to assessment appeals; and, issuing tax bills, collecting taxes and dealing with arrears. For Kelly, the major functions are 'tax base identification, tax base valuation, tax assessment, tax collection, tax enforcement and dispute resolution and taxpayer service'. 503

Five policy and administrative variables are said to determine the effectiveness of a property tax system. These are definition of the tax base, definition of the tax ratio (TR), size of the coverage ratio (CVR), the valuation ratio (VR) and the collection ratio (CLR). The first two are policy decisions and the rest are administrative related. However, some of these variables are not easy to determine. For instance, CVR is arrived at by dividing the taxable properties captured in the fiscal cadastre by the total taxable properties in a jurisdiction. In jurisdictions where the land management system is not advanced, the reason why taxable properties would miss from the fiscal cadastre is because the systems couldn't capture them at all and therefore it is not easy to capture them for purposes of calculating the CVR. ⁵⁰⁴

The application of a real property tax requires cadastral data or register of all parcels of land, including its ownership, location, area, improvements, land use and assessed value. The assessment of the tax base and maintenance of the cadastral data is costly on the part of the taxing authority. However, there is no compliance cost on property tax and accordingly the administrative cost is the total cost of collection. There is no compliance expense on the part of the taxpayer as there is no record keeping, no forms and no calculations. ⁵⁰⁵

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⁵⁰¹ *Ibid*, pp. 6-7.

⁵⁰² *Ibid*, p. 27.

⁵⁰³ Kelly, R. (2000) *supra*, p. 39.

⁵⁰⁴ Monkam, N. F. (2010) *supra*, pp.4-5; Kelly, R. (2000) *supra*, p. 39; and, Kelly, R. (2000a) *supra*, p. 5. ⁵⁰⁵Mikesell, J. L. (2003) *supra*, p. 22.

Valuation for tax purposes requires only a determination of the relative value of properties at a common point in time and not an absolute value in current market terms. Accordingly, techniques of mass assessment are widely used. 506

In developing countries, valuation and other processes face serious challenges. The valuation rolls become dated, with the result that the assessments bear little relationship to the underlying market value and the task of realigning assessments to market values become a significant financial risk. There is disequilibrium between cost and revenue collected. This leads to lack of political will to reinvest in the property tax administrative machinery. However, this is counterproductive. ⁵⁰⁷

Land and property taxation in many developing countries has very low tax rates. The ERPT is much lower than the nominal or statutory rate due to low assessment ratios and poor enforcement. The low ERPT is also caused by lags in reassessment and the inadequacy of adjustment for value changes.⁵⁰⁸

A property tax regime requires a proper process of property identification. This is usually a problem in developing countries. The revenue base information is either incomplete or out of date. Further, such information is fragmented between the national and local governments. They also do not have a system for monitoring and recording land transfers. Property records are also not computerized. As a result, taxes are not collected on all properties within the particular jurisdiction. ⁵⁰⁹

Property taxes are either flat taxes on the parcel (with adjustment for size, location and use) or are area based (with or without adjustment for location, use and other factors). In Tanzania, for instance, the tax is limited to buildings⁵¹⁰ and is based on the reproduction cost of the structure. Area-based systems, as opposed to market values based systems, are common in countries in transition from soviet–style

101a, p. 28

⁵⁰⁶*Ibid*, p. 28.

⁵⁰⁷ McCluskey, W. J., F. A. S. Plimmer & O. P. Connellan (2004) *supra*, p. 9.

⁵⁰⁸ Bird, R. M. & E. Slack (2002) *supra*, p. 24.

⁵⁰⁹ *Ibid*, pp. 28-29.

⁵¹⁰ The government owns all land.

systems. An area based system is used in the Slovak Republic and Poland.⁵¹¹ Lithuania uses both area-based and value-based assessments.⁵¹²

There are few avoidance options for property tax as the taxpayer has few alternatives for controlling liability. This is because it has few compliance requirements on property owners. Evasion can only be done with active collusion with officers of the collecting agency. However, taxpayers often ignore it and a big percentage remains uncollected. This is rife in India, the Philippines and Kenya. ⁵¹³

In the Netherlands, property tax administration was decentralized in 1992, giving the responsibility to mayors and councils of municipalities. They are therefore responsible for maintaining property records, valuation of properties and collection of the taxes. They may require owners to submit returns with information on their parcels and give opinions on the value of the property. The tax is paid by both users and owners of property. ⁵¹⁴

For purposes of administration of local taxes, especially property rates, several countries use shared and comparative administration systems. This is both vertical and horizontal. The difference usually arises in the assignment of functions between the central and local governments, mainly on the issue of valuation and collection. The following table gives an insight.⁵¹⁵

⁵¹¹Mikesell, J. L (2003) *supra*, pp. 23-24.

⁵¹² Connolly, K. & M. Bell (2010) *supra*, p. 6.

⁵¹³Mikesell, J. L. (2003) *supra*, p. 24.

⁵¹⁴*ibid*, p. 25.

⁵¹⁵*Ibid*.

	CENTRAL VALUATION	LOCAL VALUATION	
CENTRAL COLLECTION	France, Pakistan, Indonesia,	Tunisia, Slovenia	
	Sweden, Jordan, Albania,		
	Armenia, Czech Republic,		
	Georgia, Latvia, Russia,		
	Portugal, Cyprus, Estonia,		
	Jamaica, Singapore		
LOCAL COLLECTION	United Kingdom, Germany,	Brazil, India, Japan, Mexico,	
	Colombia, Austria, Turkey,	Kenya,516 Philippines,	
	Denmark, New Zealand ,	Hungary, Romania, Slovak	
	Malawi	Republic, Greece, Italy,	
		Netherlands, Switzerland,	
		United States	

Table 2: Valuation and collection of local taxes in selected jurisdictions

Subnational governments in Denmark have revenue from three kinds of property tax. These are a land tax on all plots of land, a service tax on buildings used for administration, commerce and manufacturing; and a property value tax on owner – occupied dwellings and summer houses. The central government conducts the valuation.⁵¹⁷

In Canada, there is co-operative administration of property tax between regional and local governments. Local governments establish property tax rates and collect the taxes but the province or territory establishes the basic structure and requirements, establishes the policy of valuation of property and ensures that assessment is done to the acceptable standards. The federal government is not involved.⁵¹⁸

The Canadian system attempts to provide for uniform assessment. The various provinces use four different organizational structures to conduct assessments. These

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⁵¹⁶ This position obtained before the enactment of the Constitution of Kenya, 2010, under the local authorities, and is emboldened under the new county system.

⁵¹⁷Mikesell, J. L (2003) *supra*, p. 26.

⁵¹⁸*Ibid*.

are the use of crown corporations (owned by the provincial government); non-profit corporations (owned by municipalities in the province); Provisional Tax Assessment Departments; and provincial assessment supervision (to establish assessment standards).⁵¹⁹

In Estonia, local councils set tax rates within limits set by the central government. The National Land Board estimates value. The National Tax Board collects the tax. Municipalities collect information on property transactions and submit it to the National Land Board and the National Tax Board. At the end of the valuation process, local officials calculate the taxable values of each land parcel. The national Tax Board bills and collects through its local offices. ⁵²⁰

It is noteworthy that the introduction of land tax in Estonia was not primarily for purposes of raising revenue but was more of an incentive for productive use of land returned to the families of pre-1939 owners.⁵²¹ Estonia introduced a tax based on market value in 1993. Those market values were based on formulas reflecting area, location, quality and usage.⁵²²

Malawi uses a ratings basis whereby the central government conducts valuation and local authorities set rates and collect. In Turkey, the national Ministry of Finance does the valuation and municipalities collect the taxes. ⁵²³

When tax administration is shared, it allows independence and at the same time permits administrative specialization.⁵²⁴

Valuation is considered to be the most difficult stage in property tax systems. Achieving an appropriate degree of assessment–ratio uniformity is a necessity for an equitable and productive tax. 525

⁵²⁰*Ibid*, p. 28.

⁵¹⁹*Ibid*.

⁵²¹Youngman, J. & J. Malme (n.d) *supra*, p. 2.

⁵²²*Ibid*, p. 14.

⁵²³Mikesell, J. L. (2003) *supra*, p. 28.

⁵²⁴*Ibid*.

In the interests of fairness, property taxes should be based on assessments that are uniform within each jurisdiction. The initial assessment should be enhanced by periodic revaluations to achieve fair and productive taxes. The valuation cycle should be fairly short. Where it is not possible to conduct regular reassessments, indexing can also be used. This involves using elements such as the rate of inflation. ⁵²⁶

The lack of integration between government agencies affects the updating of records. Where a property is sold, the information should be sent by the land registry to the fiscal cadastral system of the local government to reflect the new recorded sales value.⁵²⁷

An appeal system is also necessary for assessments. The process should consist of an informal review by the valuation office to deal with factual errors and differences, then a valuation review board and then an appeal to a specialized tax court.⁵²⁸

In 1993, Britain introduced property tax banding whereby each property is allocated to one of 8 value bands. Properties within the same band pay the same property tax and therefore there is no need to have detailed discrete valuations of each property.⁵²⁹

The advantages of value banding include the fact that it is a quicker and cheaper process that makes the valuer's task easier. It is a robust and simple system that does not need a mass appraisal model or a defensible value estimate and has minimal appeal challenges. It also allows for a process of competitive tendering using the expertise of the private sector. There are, however, criticisms based on the absence of revaluation and the limitations of the existing band structure. It may also be tainted with inaccuracies. ⁵³⁰

⁵²⁵*Ibid*, p. 29.

⁵²⁶ Bird, R. M. & E. Slack (2002) *supra*, pp. 29-30.

⁵²⁷ *Ibid*, p. 30.

⁵²⁸ Ibid

⁵²⁹ McCluskey, W. J., F. A. S. Plimmer & O. P. Connellan (2004) *supra*, pp. 2-3.

⁵³⁰ *Ibid*, pp. 4-5.

Political will and operational support is critical for the administration of taxes by regional and local governments. Co-operation and exchange of information (horizontally and vertically) is necessary.⁵³¹ Political will is especially critical in jurisdictions where neopatrimonialism is rife.

A wide variety of tax bases are used for land and building taxes. These include capital value, annual value, original purchase price, non-value measures such as an area base or parcel taxes, and formulary approaches. The capital-value base closely approximates a tax on real property wealth and discourages speculative withholding of land from the market. The annual-value base on the other hand closely monitors the "income with which owners may expect to pay the tax and exerts less development pressure on unimproved properties." ⁵³²

In instances where land is not being used for the most profitable use, the question of the considerations at valuation arises. Should the land be valued taking into consideration its current use or the amount a purchaser seeking a change of user would offer? In the United Kingdom, the value at current use would generally be used under the principle of *'rebus sicstantibus'* which requires that the actual condition of property govern the valuation process. In the United States, the valuation process would use the estimate that may be bid by the prospective purchaser intending to put it to the most profitable use under the principle of 'highest and best use'. The distinction is informed by the nations' history and culture. This would to a large extent depend on the purpose of the tax, that is, whether it is for the purpose of raising revenue or influencing the use of land. ⁵³³

An area-based assessment system requires levies to be charged per square meter of land or per square meter of building (or sometimes "usable" space) or a combination of the two.⁵³⁴ A true area base requiring the owners to pay the same tax

⁵³¹Mikesell, J. L. (2003) *supra*, p. 30.

⁵³²Youngman, J. & J. Malme (n.d) *supra*, p. 11.

⁵³³*Ibid*, p. 12.

⁵³⁴ Bird, R. M. & E. Slack (2002) *supra*, p. 15.

per square meter (or foot) would be unfair as it would require equal taxes for properties of different values.⁵³⁵

Parcel taxes or flat taxes require property owners to contribute a minimum amount towards the cost of public services. For instance, the State of Victoria in Australia raises 20% of its property tax revenue through a charge on each property and the remainder through an *ad valorem* levy.⁵³⁶

Area based tax systems are used in transitional countries because they lack well developed property markets and land registration systems. As such, implementation of value based taxes is hindered. Connolly & Bell therefore argue that until such a time that real estate markets are well developed in developing and transition countries and reliable market information is collected, the ideal system should be a modified area-based property tax. This is because an area-based system has the advantage of simplicity. It is deemed to be easier to understand and cheaper to administer. For agricultural land in developing countries, a simple uniform tax on a classified area basis is deemed to be suitable.

Self-assessment systems requiring property owners to place an assessed value on their properties are also used. Self-assessment is considered suitable when taxes are based on a formula that considers objective physical characteristics but it is not realistic under market-value taxes. It can lead to inaccurate estimates of property values with a tendency towards underestimation. It is also deemed to violate the principle of fairness on the basis of ability to pay as people with comparable properties will not necessarily pay comparable taxes. It will eventually lead to the erosion of the real value of the local government's revenues.

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⁵³⁵ Youngman, J. & J. Malme (n.d) *supra*, p. 12.

⁵³⁶*Ibid*, pp. 12-13.

⁵³⁷*Ibid*, p. 13.

⁵³⁸ Connolly, K. & M. Bell (2010) *supra*, pp. 6-9.

⁵³⁹ Bird, R. M. & E. Slack (2002) *supra*, pp. 19-27.

⁵⁴⁰ *Ibid*, p. 20.

⁵⁴¹Youngman, J. & J. Malme (n.d) *supra*, p. 17.

⁵⁴² Bird, R. M. & E. Slack (2002) *supra*, p. 21.

⁵⁴³ McCluskey, W. J., F. A. S. Plimmer & O. P. Connellan (2004) *supra*, p. 10.

The legal and administrative framework for real property valuation, assessment and taxation should answer the following questions:

- "[1] What is to be valued?
- [2] Who is the taxpayer?
- [3] What is the standard for valuation?
- [4] What valuation method(s) should be used?
- [5] How will the valuations be used?
- [6] How frequently will property be revalued?
- [7] Who is responsible for valuation and tax administration?
- [8] How are the results of the valuation monitored and evaluated?
- [9] What rights and responsibilities do taxpayers have in regard to the taxable values on their properties?"544

A property tax regime that taxes only land without improvements is known as "site value taxation" and it is deemed suitable as it potentially increases the efficient use of land. The owner has an incentive to put his land to its most profitable use. 545

A site value system is suitable both in terms of efficiency and equity but accurate land assessment presents a challenge. However, it has also been observed that valuation of land alone is probably easier than valuation of other assets. It may not, however, yield high revenues.⁵⁴⁶

In several jurisdictions, some properties are exempt from property tax. These include government-owned property (based on ownership), properties used for charitable purposes (based on use) and the age or disability of the owner or occupier (based on special characteristics of owner or occupier). 547

Property owned and occupied by the government is generally exempt from property taxes. In some instances, governments make payments in lieu of taxes. Other properties usually exempt include 'colleges and universities, churches and

⁵⁴⁴Youngman, J. & J. Malme (n.d) *supra*, p. 25.

⁵⁴⁵ Bird, R. M. & E. Slack (2002) *supra*, p. 12.

⁵⁴⁶ *Ibid*, p. 13. ⁵⁴⁷ *Ibid*.

cemeteries, public hospitals, charitable institutions, public roads, parks, schools, libraries, foreign embassies, property owned by international organizations... agricultural land and principal residences'. 548

There is criticism on the exemption regime. Since people working in government institutions or with other exempt owners also use local services, they ought not be exempted. There is also differential treatment between those who pay in lieu of rates and those who are exempt. The differential treatment also has an effect on the economic decisions made in respect of locations. The exemptions made narrow the tax base with the effect that if high taxes are to be raised, the remaining taxpayers suffer an increase or in the alternative; there is a reduction of revenue available to provide local services. Since the exemptions may differ between areas, this causes a disproportionate tax burden across communities.⁵⁴⁹

A value based assessment can use either a market (capital) or a rental value approach. A market value assessment estimates the value of the property in the open market. The market value is taken to be the price that would be struck between a willing buyer and a willing seller in an arm's length transaction. A rental value assessment considers the estimated rental value or net rent. 550

To estimate market value, either of three approaches is used. These are:

- a. The comparable sales approach Where the property is situated in an area where the market is active, the assessor considers the actual sale prices of similar properties.
- b. The depreciated cost approach In situations where there are no comparable sales for various reasons, the cost of replacing the improvements is considered and added to the cost of the land.
- c. The income approach Where a property has actual rental income, the assessor converts the rental income to a capital value. 551

⁵⁴⁸ Bird, R. M. & E. Slack (2002) *supra*, p. 14.

⁵⁴⁹ *Ibid*. 550 *Ibid*, pp. 15-17.

⁵⁵¹ *Ibid*, p. 16.

There are several problems associated with rental value assessment. It faces difficulty where there is rent control as it becomes difficult to estimate rental value where some are controlled and others are not. Since vacant land is not taxable under a system using rental value on current use, it rewards low return uses. It is also not easy to estimate as information on rent is not freely available. Calculating net rents is difficult as the expenses have to be taken into consideration. ⁵⁵²

A market based assessment is considered a better tax base because the benefits from services are more closely reflected in property values than in property sizes. It also has the advantage of capturing the amenities in the neighbourhood, mainly provided by the government, and as such give returns for such investments. Unlike an area-based assessment, it does not unduly burden low-income taxpayers based on the size of property. ⁵⁵³

Collection of property tax involves sending out tax bills, collecting the taxes and ensuring payment. If it is not paid within a specified period, there should be interest and late payment fee. Other enforcement measures can be used for long-term default, including sale.⁵⁵⁴

In general, there are three main appraisal options for a value-based property tax, namely self-assessment, the traditional manual approach to assessment and the computer assisted mass appraisal approach.⁵⁵⁵

The objective of a valuation system should be to achieve robustness, reliability, simplicity, transparency and explainability to the taxpayer. 556

Administrative measures are political, technical and institutional. The political class must appreciate the need for the tax and be ready to promote it. The most important technical issue is the development of a land cadastre which includes identification, registration and mapping of land titles. There should also be a land policy geared

⁵⁵² Bird, R. M. & E. Slack (2002) *supra*, pp. 17-18.

⁵⁵³ *Ibid*, pp. 18-19.

⁵⁵⁴ *Ibid*, p. 31.

⁵⁵⁵ McCluskey, W. J., F. A. S. Plimmer & O. P. Connellan (2004) supra, p.10.

towards full marketisation in the urban areas and redistribution in the rural areas. The establishment and staffing of a rating office and the adoption by government of a policy to pay grants-in-lieu of rates for its properties are additional institutional mechanisms.557

The promulgation of model legislation on property taxation has been identified as one of the measures that would enhance the position of property rating as a major revenue source. The subnational governments or counties would then adapt the model legislation to suit their own peculiar conditions. Such model law would identify counties as the rating authorities and provide for issues such as assessment base, liability, valuation, exemptions and the enforcement mechanisms. Public participation and consultative structures should also be provided for. 558

6.2.3 Pre-Devolution Administration of Property Rates in Kenya

Property rates have been under the jurisdiction of local authorities established under the Local Government Act. 559 These were city councils, municipal councils, county councils, town councils and urban councils. The rates, otherwise known as Land Rates, were administered under the Rating Act⁵⁶⁰ and the Valuation for Rating Act. 561 It is interesting to note that these two Acts have not been repealed; neither have they been amended to encompass the changed operational environment.

Section 3 of the Rating Act gives the duty to levy rates to the rating authority. By virtue of section 2 thereof, a rating authority, means a municipal council, a county council or a town council. These no longer exist, subject to section 18 of the Sixth Schedule to the Constitution of Kenya, 2010 (Transitional and Consequential Provisions).

⁵⁵⁷ Olowu, D. (2004) *supra*, p. 22.

⁵⁵⁹Chapter 265, Laws of Kenya (Repealed by Act No. 17 of 2012).

⁵⁶⁰Chapter 267, Laws of Kenya.

⁵⁶¹ Chapter 266, Laws of Kenya.

The Valuation for Rating Act is an Act intended to empower local government authorities to value land for purposes of rates. It applies to areas under local authorities in respect of which a rate on the valuation of land, other than a rate on the annual value of agricultural land, has been imposed. As noted earlier the local government authorities no longer exist.

For the purposes of levying rates, a rating authority may use any of three forms of rating. These are an area rate, ⁵⁶³ an agricultural rental value rate ⁵⁶⁴ and a site value rate ⁵⁶⁵ or a site value rate in combination with an improvement rate. ⁵⁶⁶ Local authorities in Kenya have been using the unimproved site value rate. ⁵⁶⁷ Once an authority adopts a particular form of rating, it cannot use it together with any other. ⁵⁶⁸

Kenya uses the site value taxation system. This is without factoring improvements and accordingly it is the unimproved site value system. ⁵⁶⁹ This is notwithstanding the fact that the Rating Act allows local authorities to tax either land or land and improvements. ⁵⁷⁰

The unimproved site value system is deemed to be fairly easy to apply. The cost of preparing the valuation roll is minimal. Since it only taxes the land, the owner has an

⁵⁶³Under this, one or more of the following methods be used: a flat rate; a graduated rate; a differential rate or a differential graduated rate according to the use of the land; an industrial rate; a residential rate; or such other method as the rating authority may resolve.

⁵⁶²Section 1(1).

⁵⁶⁴ This applies to land held on a lease from the government for a term of 999 years in respect of which an annual rent has been reserved, or such similar leases.

⁵⁶⁵ This applies when the valuation roll or the supplementary valuation roll does not include the value of land or when no improvement rate is levied.

⁵⁶⁶ This combines both the site value rate and an assessment for improvement rate.

⁵⁶⁷ This is the same as the site value rate. It must not exceed 4% of the unimproved value of land without the consent of the minister.

⁵⁶⁸Section 3, Rating Act.

⁵⁶⁹ Bird, R. M. & E. Slack (2002) *supra*, p. 12.

⁵⁷⁰ UN-HABITAT (2013) *Property Tax Regimes in East Africa*, The Global Urban Economic Dialogue Series, Nairobi, p. 17.

incentive to make maximum use of his land. However, it is often criticized as inequitable as it does not vary with the intensity of land use.⁵⁷¹

The power and duty to prepare a valuation roll is provided for under Section 3 of the Valuation for Rating Act which provides;

'Every local authority shall from time to time, but at least once in every ten years, or such longer period as the minister may approve, cause a valuation to be made of every rateable property within the area of the local authority in respect of which a rate on the value of land is, or is to be, imposed, and the values to be entered in a valuation roll.'

The valuer or valuers conducting the valuation were appointed by the respective local authority.⁵⁷² Some authorities, specifically Nairobi, were known to appoint their Chief Valuers and other valuers in their Valuation Section to undertake the process.⁵⁷³

The process of preparing a valuation roll and any supplementary roll is fairly technical. The technicalities provided for under statute must be clearly adhered to. Of great importance are the provisions on publication and service of notices.⁵⁷⁴

In *Jacqueline Resley v The Nairobi City Council*⁵⁷⁵ and subsequently in *Republic v The City Council of Nairobi ex parte Jacqueline Resley*,⁵⁷⁶ the court quashed the 2001 Draft Valuation Roll and the 2005 Draft Valuation Roll, respectively, for Nairobi, for failure to comply with statutory requirements.⁵⁷⁷ The effect of this was that the City Council of Nairobi could not levy rates based on the rolls.

⁵⁷³Rihal, B.S(2004) *supra*, p 20

⁵⁷¹Rihal, B.S. (2004) *supra*, pp. 43 - 44

⁵⁷²Section 7, of the Rating Act.

⁵⁷⁴ Section 30 of the Valuation for Rating Act and section 26 of the Rating Act provides for the notices. They are verbatim copies of each other.

⁵⁷⁵Nairobi High Court Miscellaneous Application No. 1517 of 2001.

⁵⁷⁶Nairobi High Court Miscellaneous Application No. 1654 of 2004.

⁵⁷⁷ Both were judicial review applications instituted by Jacqueline Resley on her own behalf and on behalf of a civil society organization she headed, WE CAN DO IT.

The question as to whether a valuation roll is amenable to *certiorari* and *mandamus* is now well settled. A public officer entrusted with a public duty and authority to determine questions affecting the rights of subjects is expected to act 'judicially', which in effect means fairly and justly in accordance with statute.⁵⁷⁸

Indeed the valuation officer is enjoined to act judicially as the ratepayer would be entitled to seek the prerogative orders of *certiorari* and *mandamus* if he establishes an error that goes to the very root of the determination of values in relation to the whole valuation list.⁵⁷⁹

The contents of the draft valuation roll or draft supplementary valuation roll are the description, situation and area of the land valued; the value of the land; the value of the unimproved land; and, the assessment of improvement rate.⁵⁸⁰

The valuer is given power of entry and inspection of any land, and also power to inspect and make extracts from all registers and other records, deeds or instruments held by any public officer or person, in which there are particulars of any land. Hindering or obstructing a valuer is an offence. The valuer may also require the rateable owner or occupier to make a return and non-compliance is an offence.⁵⁸¹

The rateable owner (who is subject to payment of rates) is either:

a) The owner of the registered freehold of, or the tenant for life of, property in possession or with a reversionary interest or in remainder expectant upon a lease or interest;⁵⁸² or

⁵⁷⁸Widdicombe, D., D. T Eve and A. Anderson (1968) *Ryde on Rating: the Law and Practice* (12th edition), Butterworth & Co. London, pp. 643–650.

The Digest: Annotated British, Commonwealth and European Cases 38(1983 reissue)(Public Health, Railways, Canals and Pipelines, Rates and Rating, Real Property) Butterworth & Co.(Published) Ltd, London, p. 465.

⁵⁸⁰Section 6, Valuation for Rating Act.

⁵⁸¹Section 5. Valuation for Rating Act.

⁵⁸² These would in effect mean the person who holds the highest interest in a parcel of land, in the nature of an absolute proprietor.

- b) The lessee holding under a registered lease for a definite term of not less than 25 years or for the natural life of any person, or any other lease, whether indefinite or renewable, where the aggregate term is at least 25 years, except a statutory tenant under the Rent Restriction Act; or
- c) A lessee of public land, or a person having an interest entitling him to possession for a definite term of less than 25 years; or
- d) A person who has ownership interest or is in possession, or is in receipt of rents or profits of a property in an area where no certificates of ownership have been issued; or
- e) In the case of Trust land, the county council;⁵⁸³ or
- f) A lessee of a local authority under a registered lease of not less than 10 years. 584

In Kenya, there is discretion in determining the tax rate. A taxpayer's liability is then determined by multiplying the assessed value with the tax rate.⁵⁸⁵ This determines the amount eventually paid by the taxpayer. To compensate the lag in conducting valuations, local authorities are known to increase this rate to rates equivalent to the inflation rate. For instance, Nairobi increased this from 2.25% in 1982 to 17% in 1999.⁵⁸⁶

The law provides for the procedure for obligations relating to the valuation rolls. This includes the establishment of valuation courts.⁵⁸⁷ Appeals from the valuation court are lodged either in the High Court⁵⁸⁸ or the Chief Magistrate's Court.⁵⁸⁹ This is done within one month of the decision.⁵⁹⁰

Section 13 of the Valuation for Rating Act provides for a statutory co-operation arrangement. A County Council may levy rates on behalf of an urban council, area

⁵⁸³ This now goes to the county government.

⁵⁸⁴Section 6, Valuation for Rating Act.

⁵⁸⁵ Bird, R. M. & E. Slack (2002) *supra*, pp. 21-22.

⁵⁸⁶ Kelly, R. (2000) *supra*, p. 46.

Section 10 - 16, Valuation for Rating Act.

⁵⁸⁸In respect of valuation courts appointed under Section 12.

⁵⁸⁹In respect of valuation courts appointed under Section 13.

⁵⁹⁰Section 19.

council or local council, to meet the expenses of that council. The County Council is then entitled to retain out of the proceeds, either the actual expenses of levying or collecting the rates or 2 ½ % of the proceeds, whichever is the lower. ⁵⁹¹

The mode of enforcement of payment of rates is by filing proceedings in a subordinate court to recover such dues by way of a plaint. Once a decree is issued, it can be executed in any of the modes provided for under the Civil Procedure Act. Unpaid rates may also be recovered from tenant or occupiers paying rent to the rateable owner.

The rating authority may also deliver a notification of a charge to the relevant registrar of lands in respect of unpaid rates, upon which the registrar is required to register the charge against the land on which the rate was levied.⁵⁹⁵

Upon demand, and where he has settled all rates, charges, and any other sums due as expenses, a rateable owner is entitled to receive a statement indicating that position and the validity period. This is referred to as the Rates Clearance Certificate. 597

The use of Rates Clearance Certificate in Kenya shifts most of the burden to the taxpayer to ensure that he clears any outstanding liabilities. This is because the certificate would be required when transferring the property, seeking business permits or other local services. However, it has not proven to be particularly effective. It however promotes forced compliance. Publishing names of delinquent

⁵⁹²Section 17.

⁵⁹¹Section 14.

⁵⁹³ Chapter 21, Laws of Kenya. These would include attachment of property, garnishee proceedings, committal to civil jail, etc

⁵⁹⁴Section 18, Valuation for Rating Act.

⁵⁹⁵Section 19.

⁵⁹⁶Section 21.

⁵⁹⁷ This is a requirement for all transactions (transfers, charges, leases) involving land situated within a rateable jurisdiction and ensures compliance.

property owners to exert social and moral pressure to pay has also been used, but without much apparent impact. ⁵⁹⁸

In Kenya, there is a lack of effective enforcement mechanisms and as such collection rates remain low. The overreliance on the rates clearance certificate has been the easier, but ineffective, route of enforcement. Other enforcement mechanisms exist, including fines, tax liens and foreclosure. Lack of political will, poor administrative systems and lack of knowledge on the existing enforcement mechanisms have been cited as reasons for failure to enforce. ⁵⁹⁹

The government and the community, for lands held by them, are required to pay contributions in lieu of rates.⁶⁰⁰

The Valuation for Rating Act gives the Minister power to make regulations for the achievement of the intentions and purposes of the Act.⁶⁰¹ The Rating Act gives the minister power to make rules for the better carrying out of the provisions and purposes of the Act.⁶⁰²

By virtue of Section 23 of the County Governments Public Finance Management Transition Act, 603 county governments, urban areas and cities are empowered to continue imposing rates and charges under the existing law 604 until a new law is enacted.

The administration of property rates has faced numerous challenges in Kenya. The revenue base information is not up to date or complete. The fiscal cadastre and valuation rolls only include between 20% and 70% of the taxable land. There is no system to monitor and record land transfers. It has also been observed that property

⁶⁰²Section 27.

⁵⁹⁸Mikesell, J. L. (2003) *supra*, p. 24.

⁵⁹⁹ Kelly, R. (2000) *supra*, p. 49.

⁶⁰⁰Section 23, Valuation for Rating Act.

⁶⁰¹Section 31.

⁶⁰³ Under section 31, this Act shall stand repealed on 30th September 2013.

⁶⁰⁴ These are the Valuation for Rating Act and the Rating Act.

records are kept manually and maintained in an *ad hoc* manner as the records are not computerized. There has also been a high percentage of tax arrears estimated at 50% in some parts of Kenya. ⁶⁰⁵ As seen in Chapter 2, the higher the tax gap, the more radical the changes that are needed. Using the percentages above, it is clear that the tax gap in the defunct local authorities was more than 40%, which is the fourth group in the categorization of tax administrations in terms of the tax gap, and the poorest.

There has been an attempt at property tax reform in Kenya. Property tax reform is ordinarily either part of a reform of the overall tax system or on its own without being part of other government initiatives. The reasons usually given for reforming property tax are to simplify the tax system; to raise more revenue; and, to remove inequities in the tax system. The reform of a property tax regime inevitably involves, in addition to any other, a reform of the assessment system. It has, however, been observed that concentrating on assessment reform may actually subvert the entire reform effort. ⁶⁰⁶

Property tax reform in Kenya was part of an overall strategy to reform local government. This was done through the Kenya Local Government Reform Programme in 1998. Rationalizing the central-local relationship, enhancing local financial management and revenue mobilization, and improving local service delivery through greater citizen participation were the key components. The intention was to establish a sustainable local revenue mobilization capacity to generate revenue with a view to improve local service delivery, enhance economic governance and alleviate poverty. 607

The reform effort focused on tax administration, especially collection and enforcement. It was intended to improve the basic management of the property tax system. It was part of an Integrated Financial Management System (IFMS) introduced for local governments. The idea was to have a simple and cost-effective field methodology for collecting property information, ensure more complete

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⁶⁰⁵ Bird, R. M. & E. Slack (2002) *supra*, pp. 28-31.

⁶⁰⁶ *Ibid*, p. 34

⁶⁰⁷ *Ibid*, p. 35. See also Kelly, R. (2000a) *Property Taxation in East Africa: The Tale of Three Reforms*, Lincoln Institute of Land Policy Working Paper WP00RK2, p. 10.

coverage and develop a computer-assisted mass appraisal (CAMA) valuation model. Pilot projects were undertaken on Nyeri and Mavoko municipalities. This approach has the advantages of objectivity, economies of scale and the ability to update values frequently. Its only drawbacks are that it has high initial costs; it is data intensive, lacks transparency in the derived models and requires suitably qualified specialized staff. It however requires a lot of data, high levels of skills and appropriate computer hardware and software.

Kelly refers to the computer-assisted pilot project as the Rates Administration Management System (RAMS). It produced the billing and collection management for Mavoko municipality for 2000 and 2001. The plan was to replicate it throughout the country upon successful implementation of the pilot project. This did not happen. ⁶¹²

The implementation of the reform effort was hampered by lack of political will and weak administration. This problem is aggravated by the fact that big political players are also substantial property owners. There is lack of taxpayer education and incentives for tax administrators. Taxpayers do not receive improved local services and therefore do not consider the taxes as fair. There is therefore need to have an improved tax administration including property identification and management, valuation and assessment, billing and collection, enforcement, and taxpayer service. 613

Overall, property rates revenue yield in Kenya has been low. A general decline has been noted. There has been no observance of statutory valuation cycles and as such the valuation rolls are outdated. This undermines the tax base and legitimacy of ratios. Collection ratios have been low. This may be related to limited technical and logistical support, for instance, computer hardware and software.⁶¹⁴

⁶⁰⁸ *Ibid*, pp. 36-37.

⁶⁰⁹ Franzsen, R. C. D. (2002) *supra*, p. 10. Unfortunately, the success or otherwise of this project is not documented

⁶¹⁰ McCluskey, W. J., F. A. S. Plimmer & O. P. Connellan (2004) *supra*, p.11.

⁶¹¹ Franzsen, R. C. D. (2002) *supra*, p. 10.

⁶¹² Kelly, R. (200a) *supra*, p. 10.

⁶¹³ Bird, R. M. & E. Slack (2002) *supra*, p. 38. See also Olowu, D. (2004) *supra*, p. 23.

⁶¹⁴ Franzsen, R. C. D. (2002) *supra*, pp. 6-7.

Lack of capacity to assess properties has been noted as a major constraint. This has been a bigger problem in the smaller local authorities, most of whom have not been able to employ qualified valuers.⁶¹⁵

There is need to focus property tax reform in Kenya on administration improvement as it remains the main obstacle. The emphasis should be on collection and enforcement, as the other functions are process towards the eventual collection of revenue.⁶¹⁶

This part on the larger part has described a tax for a defunct system of government. This was justified by the fact that county governments will directly inherit most of the system since they replaced local authorities on the geographical reach of their areas of jurisdiction. Indeed until new laws are enacted, they are still supposed to apply the two main statutes used in property rates administration by the defunct local authorities, the Rating Act and the Valuation for Rating Act.

The Constitution of Kenya, 2010, identifies democracy and participation of the people as one of the national values and principles of governance. The Constitution also provides for the principles of public finance, among them public participation in financial matters. This, in effect calls for public participation in the identification, assessment, collection and dispute resolution.

6.3 ENTERTAINMENT TAXES

6.3.1 Introduction

The Constitution of Kenya, 2010, does not define what is entailed in the term 'entertainment taxes'. 619

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⁶¹⁵ *Ibid*, pp. 8-9.

⁶¹⁶ Kelly, R. (2000) *supra*, p. 50.

⁶¹⁷ Article 10 (2) (a).

⁶¹⁸ Article 201 provides:

[&]quot;The following principles shall guide all aspects of public finance in the Republic-

⁽a) there shall be openness and accountability, including public participation in financial matters:..."

⁶¹⁹Note that this term is used in the plural sense denoting that the constitution envisages several taxes.

Simply said, entertainment tax is tax on entertainment. There would therefore be need to understand what entertainment entails. This is not easy to define. However, it can be understood by referring to the various activities that would be deemed as including entertainment. These would include theatre, movies, amusement parks, festivals, music shows, television services and radio broadcasting services.⁶²⁰

There is also no clarity on whether what is taxable is the entertainment activity or the income from the entertainment. Whereas it may be argued that income tax is clearly under the jurisdiction of the national government by virtue of Article 209 (1) of the Constitution, there is a thin line between the two. The reasonable interpretation is that income cannot be taxed by the county government and therefore it is the person enjoying the entertainment who is taxable and not the provider of the service.

6.3.2 Administration of Entertainment Taxes

Different countries have different perspectives of entertainment tax.

In Estonia, it is paid by the organizers of paid entertainment activities on the municipality or town territory and by the owners of entertainment businesses on the municipality or town territory. The tax is levied on the tickets sold. The tickets must be registered within the jurisdiction.⁶²¹

The foregoing reflects a narrow view of entertainment tax; one that requires the use of tickets.

In India, movie tickets, large commercial shows and large private festival celebrations incur an entertainment tax, depending on the state. Entertainment tax is exclusively reserved as a source of revenue for the state governments as it is listed in List 2 of the seventh Schedule to the Constitution of India.

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⁶²⁰The danger with the lack of a definition in the law is that the list is endless and counties would be at liberty to impose a tax on any activity they deem entertainment.

⁶²¹Sootla, G., K. Kasemets and S.K Kunnapuu (2001) *supra*, p. 162.

Entertainment tax in India has grown to include pay television services. By its very nature the component of entertainment in such services is intrinsically intertwined in the transaction of service and as such cannot be separated from the whole transaction. It so happens, therefore, that it is subject to tax by both the union and the state governments. However, by virtue of Article 246 of the Constitution of India, in case of conflict between the powers of the union and the states, the Union's power to tax supersedes the power of the state to levy tax on the taxable event or in relation to the subject or object of taxation.

The entertainment tax structure in India varies across states. This causes the entertainment industry to face double taxation challenges.

Traditionally the classes of entertainment to which entertainment tax applies in Nigeria include cinematograph exhibitions, night clubs and casinos, and horse racing. 622 In Kenya, by virtue of the Fourth Schedule to the Constitution, casinos are listed as a national government function.

In the United States, individual states have their own laws on entertainment tax. For instance, the State of Nevada has legislation referred to as Tax on Live Entertainment 623 that goes on to define "Live entertainment status" as that condition which renders the admission to a facility or the selling of food, refreshments or merchandise subject to the tax imposed by the Act. 624 In Philadelphia, a lap dance in a strip club is chargeable to amusement tax. 625

Some countries also impose amusement tax, which refers to a tax levied on such forms of entertainment as motion pictures, theatre, concert and sporting event and is

⁶²² Federal Inland Revenue Service (2012) A comprehensive Tax History of Nigeria, Safari Books, p. 262.

⁶²³Chapter 368A.

⁶²⁴NAC 368A.060.

⁶²⁵ Davis, A "Society: Philadelphia Strip Clubs Face Double 'Entertainment Tax'" in <u>www.opposingviews.com</u> accessed on 18th July 2013.

included in the total admission price.⁶²⁶ This tax is imposed by most states in the United States.

In *Classic Affairs v. Commissioner of Revenue*, 627 the court held that an amusement tax means a tax on the sales of food, refreshments, services, or merchandise served or provided in any bar, restaurant, hall, cabaret, or other public place where music and dancing privileges or any other entertainment are offered. 628 This gives a wide base of amusement (or entertainment) tax which in Kenya, however, unless used sparingly would bring into its ambit some aspects of income tax and VAT thereby falling outside the authority of counties.

In the Philippines, amusement tax is the tax collected from the proprietors, lessees, or operators of theatres, cinemas, concert halls, circuses, boxing stadia and other places of amusement. 629

6.3.4 Administration of Entertainment Tax in Kenya

The Entertainments Tax Act⁶³⁰ is an Act for the imposition and recovery of a tax in respect of entertainments. The Act provides that entertainment includes an exhibition, performance or performance to which persons are admitted for payment. It, however, excludes entertainment offered by persons registered for VAT purposes under the Value Added Tax Act;⁶³¹ stage plays and performances conducted by educational institutions approved by the Minister for Education⁶³² as part of learning; and sports, games or cultural performances conducted under the auspices of the Ministry of Culture and Social Services.⁶³³ This definition would include activities

⁶²⁶www.dictionary.reference.com accessed on 19th July 2013.

^{627 1993} Minn. TAX LEXIS 8 (Minn T. C 1993).

⁶²⁸ www.uslegal.com accessed on 19th July 2013.

⁶²⁹ www.pinoylawyer.org accessed on 19th July 2013.

⁶³⁰ Chapter 479, Laws of Kenya.

⁶³¹ Chapter 476, Laws of Kenya.

⁶³²Currently, Cabinet Secretary for Education.

⁶³³Section 2.

such as bull-fighting in Kakamega County, *mwomboko* or *ndumo* dance in Nyeri County and similar entertainment activities.

The failure by the Act to give entertainment a succinct definition leaves the term entertainment open to diverse interpretations.

The Entertainments Tax Act is administered and enforced by KRA by virtue of Part I of the First Schedule to the Kenya Revenue Authority Act. 634

The entertainments tax is chargeable, leviable and payable on all payments for admission to entertainment. The rate is set at 18% of admission fees. The method of payment is by tickets denoting that the tax has been paid, or other mechanical mode such as a barrier that would automatically register the number of persons admitted after which the proprietor accounts for the tax due. The following that the second se

The District Commissioner of the respective district has power to exempt certain entertainments from payment of entertainments tax. These are the ones conducted for the purpose of a charitable, philanthropic, educational, medical, scientific or cultural nature. 637

The collector of entertainments tax is a District Commissioner, a Revenue officer, or any person appointed by the District Commissioner in writing to be a collector. The tax so collected is the revenue of the government.

The Act is silent on the fund to which the revenue is payable or the purposes for which it may be applied.

⁶³⁶Section 4.

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⁶³⁴ Chapter 469, Laws of Kenya.

⁶³⁵Section 3.

⁶³⁷Section 9.

⁶³⁸Section 2.

⁶³⁹Section 13.

The proprietor may collect the tax by use of a 'Government Ticket' or by means of stamps or applying to the collector to pay periodically. 641

The Hotel Accommodation Tax Act,⁶⁴² an Act for the imposition of a tax in respect of the line and occupation of accommodation in hotels and similar establishment, was repealed by the Tourism Act.⁶⁴³ The effect of this is that the tax was abolished.

Under the Tourism Act, the Minister for Finance may propose tax and other fiscal incentives, disincentives or fees to induce or promote the development of sustainable tourism. This may include tax rebates.⁶⁴⁴

The Tourism Act also repealed the Hotels and Restaurants Act⁶⁴⁵ which provided for the licensing of hotels, hotel managers and restaurants and the imposition of a training levy.

The Betting, Lotteries and Gaming Act⁶⁴⁶ provides for the control and licensing of betting and gaming premises; for the imposition and recovery of a tax on betting and gaming; and for the authorization of lotteries. The tax under the Act includes the charges, fees and levies imposed under the Act.⁶⁴⁷ By virtue of Part II of the First Schedule to the KRA Act, the taxation provisions of this Act are administered and enforced by KRA. The fees and charges payable are collected by the Betting Control and Licensing Board and are paid into the consolidated fund.⁶⁴⁸

As noted earlier, the counties are expected to formulate laws to enable them take over from the national government the taxes that have been devolved to them.

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⁶⁴⁰ This is a ticket supplied by a collector.

⁶⁴¹Regulation 3, the Entertainment Tax Regulations.

⁶⁴² Chapter 478, Laws of Kenya.

⁶⁴³ Act No. 28 of 2011.

⁶⁴⁴Section 106.

⁶⁴⁵ Chapter 494, Laws of Kenya.

⁶⁴⁶ Chapter 131, Laws of Kenva.

⁶⁴⁷Section 2.

⁶⁴⁸Section 69.

Towards this end, the Nairobi City County has enacted the Nairobi City County Betting, Lotteries and Gaming Act, 2014⁶⁴⁹ to 'provide for the licensing and regulation of betting and gaming activities and premises; for authorizing of public lotteries in the county; and for connected purposes.'650 It is noteworthy that when the Bill for this Act was first published, the Preamble included 'for the imposition and recovery of a tax on betting and gaming' as part of the general object. Indeed the proposed section 12 provided as follows:

"There shall be paid by each casino a gaming tax in respect of cumulative winnings for each month at such rate as may be determined by the executive committee member responsible for finance."

This clause was deleted by the Sectoral Committee on Culture and Community Services during the consideration of memoranda submitted on the Bill. The specific memorandum in objection had alleged that the clause "essentially imposed an income tax pursuant to Section 209(1)(a) of the Constitution, thus contravening national legislation." As a result, the Committee resolved to delete it. In the words of the Committee, "[t]he clause raises a number of contentious issues for which concerned stakeholders are currently in talks with the Executive on the way forward.... An amendment will be brought once a way forward as regard the provisions of this deleted section is agreed on." This demonstrates the uncertainty surrounding gaming tax, and by extension, entertainment taxes. 651

6.4 ADMINISTRATION OF OTHER COUNTY TAXES

The Constitution of Kenya, 2010, empowers counties to impose any other tax that they are authorized to impose by an Act of Parliament.⁶⁵²

No other tax has been authorized by an Act of Parliament.

⁶⁴⁹ Nairobi City County Act No. 5 of 2014.

⁶⁵⁰ Preamble.

⁶⁵¹ County Government of Nairobi City (2004) Report of the Sectoral Committee on Culture and Community Services on the Consideration of the Nairobi City County Betting, Lotteries and Gaming Bill, 2014, Nairobi City County Assembly, First Assembly – Second Session, March. ⁶⁵²Article 209(3) (c).

Other taxes that may be available to counties include boat tax (for owners of yachts and boats), motor vehicle tax (on owners of nationally-registered motor vehicles), commercial and advertisement tax (on advertisements and posters) tax on closing roads and streets (on individuals and organizations when organizing demonstrations, processions and other events), on undertaking building or repair works leading to closure, tax on keeping animals (on owners of animals) and burials. 653

6.5 THE NATIONAL INTEREST AS THE OVERRIDING PRINCIPLE IN TERMS OF ARTICLE 209(5) OF THE CONSTITUTION

As noted earlier, the taxation powers of a county are restricted by Article 209(5) of the Constitution of Kenya. This is to the extent that the exercise of those powers should not prejudice national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labour. Section 161 of the Public Finance Management Act⁶⁵⁴ enjoins county governments to the observance of this requirement and indeed requires them to seek the views of the Cabinet Secretary for the National Treasury and the Commission on Revenue Allocation before exercising the power.⁶⁵⁵

The import of the Article is to subordinate the economic interests of counties to those of the nation. It therefore means that without doubt, where in the exercise of its revenue raising powers, a county formulates economic policies that are inconsistent with national policies, the national policies shall prevail and the county policies shall be void to the extent of the inconsistency. This subordination is only in respect to economic matters. This leaves out other considerations such as those that are political, cultural or social in nature.

"In imposing a tax or other revenue raising measure, a county government shall ensure that the tax or measure conforms to Article 209(5) the Constitution and any other legislation, and before imposing any tax or revenue raising measures under this Article, shall seek views of the Cabinet Secretary and the Commission on Revenue Allocation."

⁶⁵³Sootla, G., K. Kasemets and S. Kunnapuu (2001) *supra*, pp. 161-162.

⁶⁵⁴ Act No. 18 of 2012.

⁶⁵⁵ Section 161 provides:

Economic policy refers to the set of controls used by the government to regulate economic activity. It can be classified into fiscal policy (taxation, government spending, and public debt), monetary policy (interest rates and inflation), and trade policy (tariffs and trade agreements). Most aspects of government have an economic aspect. These include macroeconomic stabilization policy;⁶⁵⁶ trade policy;⁶⁵⁷ policies designed to create economic growth; policies related to development economics; policies dealing with the redistribution of income, property and/or wealth; and also regulatory policy, anti-trust policy, industrial policy and technology-based economic development policy.⁶⁵⁸

Tax administration, whereas it is governed by statute, is run through fiscal policy. This is the use of taxation and government spending to influence the economy. This entails the changing of tax rates or the rules on liability to tax.⁶⁵⁹

Policy may either be discretionary policy or rule-based policy. The advantage of discretionary policy is that it allows policymakers to respond quickly to events. However, it can be subject to dynamic inconsistency making it non-credible and ultimately ineffective. A rule-based policy can be more credible. This is because it is more transparent and easier to anticipate. It is also possible to have a compromise between strict discretionary and strict rule-based policy by granting discretionary power to an independent body. A non-discretionary policy can also arise in the form of a set of policies imposed by an international body, such as the IMF.

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⁶⁵⁶ This attempts to keep the money supply growing at a rate that doesn't result in excessive inflation.

⁶⁵⁷ This refers to tariffs, trade agreements and the institutions that govern them.

⁶⁵⁸Black, J., N. Hashimzade and G. Myles (2012) *Oxford Dictionary of Economics*, 4th Edition, Oxford University Press, Oxford, p. 122.

⁶⁵⁹ *Ibid*, p. 157.

⁶⁶⁰ For instance, a government may say it intends to raise interest rates indefinitely to bring inflation under control but then relax the stance later.

⁶⁶¹ Examples would include fixed exchange rates and interest rate rules. Some policy rules can be imposed by external bodies, such as in the case of the exchange rate mechanism for currency.

⁶⁶² For instance, central banks may be given the power to set interest rates without government interference, without necessarily adopting any rules.

⁶⁶³These come as conditionalities as a requirement for further assistance and support.

The incorporation of economic principles and concepts in the Constitution comes with new challenges. There has not been any judicial decision in Kenya interpreting economic concepts in the constitutional framework. This concept is variously referred to as constitutional economics, ⁶⁶⁴ economics of constitutionalism, ⁶⁶⁵ economic theory of constitutions and the economic principles of constitutions. ⁶⁶⁷

Interpretation of constitutional provisions cannot be exhausted by the study of the text, context and background of the constitution. This is because it is influenced by certain jurisprudential principles, such as judicial self-restraint⁶⁶⁸ and *stare decisis*.⁶⁶⁹ Article 209(5) has not been subjected to judicial interpretation and as such we do not have the benefit of judicial analysis of the same.

Constitutions cannot be appraised on economic grounds alone even where the purpose and substance of the interpretation is largely economic. This is because the first task of interpretation is interpretation and not choice of optimal policies. In addition to suggesting the desirability of free markets, the study of economics also points out the illogical features in existing interpretations of the 'economic clauses of the constitution'.⁶⁷⁰

⁶⁶⁴ This term was coined in 1982 by the US economist Richard McKenzie as a topic of discussion at a conference held in Washington, DC. This was then adopted by another American economist, James M. Buchanan, as a name for a new academic sub-discipline.

⁶⁶⁵ This is the term used by Richard A. Posner, Judge, US Court of Appeals for the Seventh Circuit and Senior Lecturer, University of Chicago Law School (as he then was) in his seminal work, "the Constitution as an Economic Document." In referring to past references to the discipline, he also uses the term "economic theory of the constitution".

⁶⁶⁶ This is used by James M. Buchanan and Gordon Tullock in their work, "The Calculus of Consent: Logical Foundations of Constitutional Democracy". Note that James Buchanan has also used the term "constitutional economics".

⁶⁶⁷ This term is used by Prof. Jurgen G. Backhaus of the University of Erfurt, Germany.

⁶⁶⁸ This refers to a disposition to limit the power of the courts vis-à-vis the other organs of government.

⁶⁶⁹ Posner, R. A. (1987) "The Constitution as an Economic Document," 56 *George Washington Law Review* 4, p. 36.

⁶⁷⁰ *Ibid*, p. 20.

The economic libertarian approach to constitutionalism diminishes the role of democracy. Such an approach envisages a drastic curtailment, across the board, in the scope of permissible legislative, executive and administrative action. It does not redirect constitutional protection from personal liberties to economic liberties.⁶⁷¹

The economic analysis of law can take any of three different approaches⁶⁷², that is, the predictive analysis,⁶⁷³ the functional interpretation⁶⁷⁴ and the normative analysis. The normative analysis looks at the norms embodied in legal rules. Economic analysis can therefore assist in uncovering the relationship between particular norms or it can show the extent to which there are trade-offs between different norms,⁶⁷⁵ such as between national interest and powers of devolved units.

Constitutional norms are not beyond the scope of economic analysis.⁶⁷⁶ Whereas the legal culture of a country is an important consideration, certain conditions must be met in what would need constitutional guarantee as the economic framework. These are freedom of contract; guarantee of private property; synchronization of control and liability; constancy and predictability of economic policy; provision of a stable currency; and, open access to markets.⁶⁷⁷

Constitutional guarantees may either be basic rights enjoyed by natural or legal persons or procedural requirements of such rights or procedures or a set of such rights and procedures.⁶⁷⁸ Article 209(5) is more of procedural guarantees.

Procedural guarantees may either be guarantees regulating the relationship between public bodies or guarantees regulating the relationship between public bodies and

⁶⁷¹*Ibid*, p.21.

⁶⁷² Voight (1999) identifies two approaches: the normative and the positive approach.

⁶⁷³ This tries to answer the question as to what are the likely consequences of a particular legal rule.

⁶⁷⁴ This tries to answer the question as to why a particular legal arrangement has taken the form it has.

⁶⁷⁵ Backhaus, J. G. (2001) Economic Principles of Constitutions: An Economic Analysis of Constitutional Law,

[&]quot;Introduction".

⁶⁷⁶ Ibid.

⁶⁷⁷ *Ibid*, Part I.

⁶⁷⁸ *Ibid*.

citizens.⁶⁷⁹ Article 209(5) points more towards the relationship between public bodies.

Procedural principles regulating relationships between public bodies include those rules regulating the domains of competence of the various public bodies with respect to each other including the areas of cooperation, mutual control or hierarchical control.⁶⁸⁰

A constitution is an economic document requiring an economic approach.⁶⁸¹ The Constitution of Kenya is explicitly economic.

The term "policy" is new to the text of the constitution in Kenya. The Constitution of Kenya, 2010, has used the term in no less than 23 instances. Under Article 21,⁶⁸² the government is under a duty to take policy measures to achieve a progressive realization of the social and economic rights under Article 43.⁶⁸³ There is need for an appreciation of the policy process.⁶⁸⁴

⁶⁸¹ Macey, J. R. (1987) "Competing Economic Views of the Constitution," p. 80.

- (a) To the highest attainable standard of health, which includes the right to health care services, including reproductive health care;
- (b) To accessible and adequate housing, and to reasonable standards of sanitation;
- (c) To be free from hunger, and to have adequate food of acceptable quality;
- (d) To clean and safe water in adequate quantities;
- (e) To social security; and
- (f) To education."

⁶⁷⁹ *Ibid*, Part II.

⁶⁸⁰ Ihid

⁶⁸² Article 21(2) provides: "The State shall take legislative, policy and other measures, including the setting of standards, to achieve the progressive realization of the rights guaranteed under Article 43".

⁶⁸³ Article 43(1) provides: Every person has the right –

⁶⁸⁴ Sihanya, B. (2011) *The Presidency and Public Authority in Kenya's New Constitutional Order*, Constitution Working Paper No. 2, Society for International Development, Nairobi, p. 16.

Sihanya argues that under the Constitution, policy making is an executive function. Accordingly, the involvement of parliament in the endeavour, for instance, in the passing of Sessional Papers, may be unconstitutional or constitutionally suspect.⁶⁸⁵

The process is now open to public scrutiny and criticism. It must be participatory, inclusive and transparent.⁶⁸⁶

The economic terms used in Article 209(5) must be well understood to appreciate the extent of the powers of the counties in respect of raising of revenue. Unfortunately, the Constitution does not offer help as none of these terms is defined in the Interpretation Article.⁶⁸⁷

The question therefore arises as to who determines what falls within the Article. One of the major principles of taxation is certainty. It would therefore be a breach of the canons of taxation to leave this matter open to diverse interpretations. To avoid this, national legislation is required to provide for the mode to be used to determine whether any revenue raising power exercised by a county is in conformity with Article 209(5).

In general, limits have to be set for local tax rates to avoid distortions. There is especially need to have a minimum tax rate to avoid distorting tax competition. This is because richer counties may lower rates to attract business resulting in location shifts. The generous jurisdiction will in any event be unable to sustain the policy. Maximum rates may also be necessary to prevent distorting tax exporting, where a county levies higher tax rates on industries in the belief that the ultimate tax burden will be borne by non-residents. Tax exporting severs the connection between payers and beneficiaries and breeds inefficiency in decentralized fiscal policy. Such decentralized redistribution policies are usually self-defeating.

⁶⁸⁵ *Ibid*.

⁶⁸⁶ *Ibid*, p. 17.

⁶⁸⁷ Article 260.

⁶⁸⁸ Bird, R. M. & E. Slack (2002) *supra*, p. 22. See also Olowu, D. (2004) "Property Taxation and Democratic Decentralization in Developing Countries," *Working Paper Series No. 401*, p. 7. ⁶⁸⁹ Olowu, D. (2004) *supra*, p. 7.

Further, in the event of a dispute on the Article, there is no dispute resolution mechanism.

6.6 **RESOLUTION OF DISPUTES**

The disputes that may arise in respect of the exercise of a county's revenue raising powers may take any of three forms. The dispute may be between a county and the national government; between two or more counties; or between a county and taxpayers. There is no express enactment for the resolution of such disputes. The latter can be dealt with under county legislation but the first two require an intercounty or national intervention. In a situation where an entertainment activity, for instance, transcends boundaries of two counties, the two would be entitled to tax arising thereto. However, the circumstances may lead to a situation of double taxation and accordingly there is need for a dispute resolution mechanism.

Section 187 of the Public Finance Management Act provides for the establishment of the Intergovernmental Budget and Economic Council (IBEC) with the purpose of providing a forum for consultation and cooperation between the national government and county governments on various matters of mutual interest. 690 While some of

⁶⁹⁰ Section 187(2) provides:

[&]quot;The purpose of the Council is to provide a forum for consultation and cooperation between the national government and county governments on -

⁽a) the contents of the Budget Policy Statement, the Budget Review and Outlook Paper and the Medium-Term Debt Management Strategy;

⁽b) matters relating to budgeting, the economy and financial management and integrated development at the national and county level;

⁽c) matters relating to borrowing and the framework for national government loan guarantees, criteria for guarantees and eligibility for guarantees;

⁽d) agree on the schedule for the disbursement of available cash from the Consolidated Fund on the basis of cash flow projections;

⁽e) any proposed legislation or policy which has a financial implication for the counties, or for any specific county or counties;

⁽f) any proposed regulations to this Act; and

those matters relate to economic and financial matters, the Act does not provide for a dispute resolution mechanism.

Disputes are likely to arise regarding the application of Article 209(5) of the Constitution and the scenario where a county may disagree with the views of the Cabinet Secretary for the National Treasury and the Commission on Revenue Allocation made pursuant to Section 161 of the Public Finance Management Act.

The dispute settlement mechanism adopted should be compliant with the provisions of Articles 10(2) (a) and 201(a) of the Constitution in respect to public participation. The mechanism should also promote efficiency and certainty. Due to these considerations, a constitutional application to the High Court may not be the best way to handle such disputes. A specialised tribunal would be better placed to resolve such disputes.

The Constitution affords every person the right to fair administrative action. This, therefore, would require that where a dispute arises between a county and a taxpayer in relation to imposition, assessment and collection of a tax, the county is then enjoined to fairly address the grievance by the taxpayer. This may be done either by the County Treasury or a tribunal established for such purposes.⁶⁹¹

6.7 PRIMARY RESEARCH FINDINGS

The methodology of research applied in primary research is described in Chapter 1.

⁽g) recommendations on the equitable distribution of revenue between the national and county governments and amongst the county governments as provided in Section 190; and

⁽h) any other matter which the Deputy President in consultation with other Council members may decide.

⁶⁹¹ Article 47 of the Constitution of Kenya, 2010, provides:

⁽¹⁾ Every person has the right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair.

⁽²⁾ If a right or fundamental freedom of a person has been or is likely to be adversely affected by administrative action, the person has the right to be given written reasons for the action.

6.7.1 Findings from KRA Officers

The Public Finance Management Act gives room for the counties to enlist KRA to collect county revenues on their behalf. On this basis, KRA conducted research on the requirements to enable it collect county revenue in the event it was called upon to do so. This included the cost of establishing KRA offices in 20 counties where it does not have offices as well as the cost of collection. KRA is therefore ready to undertake the task if called upon to do so.

Setting up new systems for county revenue collection can be an expensive venture. KRA has systems in place which the county governments can benefit from through contracting KRA to collect on their behalf to give them time to build capacity to collect revenue on their own.

Counties should establish the taxes payable to them and then adopt a computerized system in collaboration with the banks to assist them in collection. This would lead to efficiency in tax administration.

Counties should also have a database of all their taxpayers. They should also consider linking their systems with those of KRA.

6.7.2 Findings from Taxpayers

The respondents suggested that the various tax administration reform measures should include minimizing types of taxes; convincing citizens that their taxes will be used in the right way; collection of taxes at source; widening of tax base; the tax collected should be accounted for to encourage taxpayers to pay more; and, tax payment and compliance should be hassle-free. Minimizing types of taxes would mean that in addition to property and entertainment taxes, the inventory of county taxes should not be increased to a level that would be confusing to taxpayers. There should also be transparency and accountability in the spending of taxes to convince citizens that their taxes are spent well with a view to enhancing compliance. The mode of compliance with the tax requirements should also be made simple so that it

does not unduly inconvenience taxpayers. Widening of the tax base, especially as it applies to property rates and entertainment taxes may not be a viable proposal and all that it needs is efficiency in administration.

6.7.3 Findings from Tax Professionals

Some of the ways of modelling effective tax administration would include simplified legislation. For instance, one respondent gave the example of transfer pricing where the requirement to price goods at arm's length leads to a lot of subjectivity. It would be more effective if for instance thresholds were established detailing the extent to which parties can have related party transactions. There is need to educate masses on the tax compliance. Tax infrastructure should be improved, as opposed to simply introducing technology based system for tax compliance.

6.8 CONCLUSION

County tax administration in Kenya involves the administration of property rates and entertainment taxes. The Constitution provides that counties may also impose other taxes as provided for by statute, which has not been done.

Property rates are the rates that were hitherto administered as rates by the local authorities established under the repealed Local Government Act. They were administered by the application of the Valuation for Rating Act and the Rating Act. For transitional purposes, these two statutes are still in force. There is no legal regime yet for the administration of property rates in Kenya under the current constitutional dispensation.

No area of taxation is more dependent on administration than property taxation. The administration of property tax impacts not only on the revenue but also equity and efficiency. Poor tax administration is an impediment to implementing property tax. Counties should develop capacity to administer it. They should computerize their

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⁶⁹² This was used as an illustration by a respondent. This study does not intend to go deeper into transfer pricing as the same does not apply to county taxes.

systems so that all taxable properties are included, values are updated on a regular basis, collection rates are enhanced and enforcement is structured. ⁶⁹³

Property tax reform should be politically acceptable and administratively feasible. The increased taxes should be designed properly from an economic perspective.⁶⁹⁴

Efficient administration of property rates would defeat the fiscal paradox of property tax by making it an important source of county revenue as it should be. This would be an improvement on the hitherto obtaining situation.

The Entertainments Tax Act is still in force and is administered by KRA. This is unconstitutional as entertainment tax is now under the administration of county governments. There is no national legislation to guide counties in this respect.

Article 209(5) of the Constitution provides for the overriding principle that must guide county governments in the exercise of their revenue raising powers. This is further enunciated under the Public Finance Management Act.

The principle of public participation should be observed in the formulation of laws for county tax administration.

⁶⁹⁴ *Ibid*, p. 43.

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⁶⁹³ See Bird, R. M. & E. Slack (2002) *supra*, p. 27.

CHAPTER 7

PROPOSALS FOR REFORM

7.1 INTRODUCTION

This study started on the premise that whereas there have been reforms of tax administration in Kenya, they lack a discernible methodology. The reforms appear haphazard and deficient in measurable expectations. There is therefore need to ensure that national tax administration reform hiccups are not devolved to the counties.

The research therefore was designed to determine whether the PIN and taxpayer registration regime at the national level, the concept of ARAs and the electronic and automated systems used by the KRA are suitable for the administration of county taxes in Kenya. It was also intended to borrow good practices from the foregoing and use it, together with other data, to address the problem at hand.

It is important to note that this study did not intend to propose reforms for national tax administration but only to use the existing tax administration and concomitant reforms as a basis upon which reforms for county tax administration can be proposed. This was informed by the fact that at the time of commencement of this research, county tax administration systems were virtually non-existent. The national regime was therefore the natural basis upon which reforms could be envisaged.

Whereas reform of tax administration is possible, it requires multi-pronged action. This would include the simplification of the tax structure, establishing and accepting appropriate strategy adjustable to the moment, understanding situation and conditions of the counties and political resoluteness as a driver.⁶⁹⁵

This Chapter highlights the lessons learnt from the various tax administration reform measures undertaken in Kenya, and the same is considered in light of developments

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⁶⁹⁵Bejakovic, P. (undated) *supra*, p. 19.

observed in other jurisdictions. This will come in handy eventually in the modelling of a strategy for the sustainable administration of county taxes in Kenya. Proposals for reform will then be made.

7.2 IDENTIFIABLE LESSONS

7.2.1 Identification and Registration of Taxpayers

Undoubtedly, taxpayer identification and registration is necessary for the proper administration of a tax. It enables the tax authority to identify its clients, make projections and collect the tax.

The PIN system operated in Kenya has gone to a great extent in enhancing tax administration. Though it has faced marked opposition (in the failure to register unless compelled either directly 696 or through circumstances), it has achieved widespread use. Indeed, this has to a great extent been promoted by the use of the PIN in accessing other non-tax services. Whereas this can be said to be contradictory to the principles of personal liberty and the ideals of democracy, it is one of the limitations and restrictions to the personal freedoms that should be there as a ticket to live in a civilised and progressive society.

It is, however, noteworthy that despite the fact that the hitherto existing local authorities in Kenya did not have any formal taxpayer identification and registration system, their tax collection was relatively simple and smooth, its effectiveness only being hindered by extraneous matters such as corruption and weaknesses in the land ownership regime.

Taxpayer identification and registration for counties would face serious challenges. This is especially because their main tax base is property. The dilemma would be on whether to register taxpayers, or just register the properties that are the subject of

register and issue a PIN to a person. This is in addition to the provisions of Section 132(2) which gives the

⁶⁹⁶ As seen in Chapter 2, under Section 132(7) of the Income Tax Act, the Commissioner may compulsorily

tax or both. A taxpayer register for a county would need constant updating, due to unending transactions involving property.

It has also been observed that the PIN used by KRA is now in widespread use. The question is whether county tax systems should plug into it or establish their own systems given the forms of taxes allocated to them. The advantages of plugging into the national system include the ease of access to information and its application to ensure compliance. However, data security issues arise. Further, there may be coordination and co-operation problems. In fact, being in control of the administration and enforcement of its own tax base gives a subnational government the opportunity to plan and make policy decisions. This was discussed in Chapter 6.

Co-operation and exchange of information, both horizontally and vertically, between national and subnational governments can improve administration and make compliance easier. It is important to coordinate registration for national and subnational taxes as this would promote business development and facilitate information exchange for administration. The use of a single taxpayer identification number to the greatest extent possible and the exchange of audit and other compliance data to the fullest extent permitted by law are also crucial. ⁶⁹⁷

7.2.2 Autonomous Revenue Authorities

The establishment of ARAs in Africa, including the establishment of KRA, has been driven by external forces. ARAs have been viewed as the face and base of reform in tax administration. Whereas in principle there is no problem with the approach, it appeared to be likely to suffer from tax culture shock and lag.

ARAs have facilitated wide ranging tax administration reforms. However, they have not necessarily translated to an increase in public revenue. The tax/GDP ratio has from time to time dropped in several African countries.

⁶⁹⁷ Mikesell, J. L. (2003) *supra*, p. 30.

Since the establishment of KRA, tax revenue has nominally increased in Kenya. However, there is no conclusive data to show that this is because of its establishment. Revenues are as a result of a combination of factors including the general improvement in the economic and political environment. The explanation for this may be in the fact that the objective of establishing KRA was primarily to improve effectiveness, efficiency and equity in tax administration, unlike in other jurisdictions where it was to increase tax revenues. However, these objects are inseparable.

ARAs, *prima facie*, have apparent benefits. However, benefits such as increased revenues can still be realised without the costs of establishing a new agency. ARAs are more costly than the departments they replace, and their promoters may be those who stand to benefit. Further, some technical roles of independent departments are lost upon establishment of ARAs.

This study observes that ARAs are not a universal solution to tax administration and are not always necessary. They are not an alternative to public service reform and indeed contribute to fragmentation and disharmony in the public service. The problems of inter-agency co-operation are still to be addressed. The autonomy does not guarantee an end to political interference and legal and political factors may continue constraining the agency. Indeed their establishment is a threat to synchronization of tax collection and tax policy.

As seen earlier, ARAs do not guarantee insulation from political interference, incompetence and malpractice. These factors should therefore not form the basis for the establishment of an ARA.⁶⁹⁸

The hitherto existing local authorities did not have ARAs for the collection of revenue due to them. They had departments in-charge of rates and other licensing services.

The Constitution of Kenya provides for a Revenue Fund, which is required to be provided for by national legislation and county legislation and regulated by the

⁶⁹⁸ See von Soest, C. (2008) *supra*, p. 43.

Controller of Budget. This is administered by the County Treasury. The County Revenue Fund falls short of an ARA. It does not have autonomy from the County Executive. Its functions are akin to those of the Consolidated Fund at the national level.

The establishment of ARAs for counties would not be a viable option. This is because of the demerits already noted on ARAs generally. There are implications related to costs, personnel and the disconnect in policy formulation and implementation. Indeed it is unlikely that they would benefit from the acknowledged advantages of ARAs, partly because their tax bases are too restricted, and almost not viable. However, attempts should be made to ensure that the apparent benefits of ARAs are not lost within the existing structure and County Treasuries should devise means to introduce them into the system.

7.2.3 Electronic and Automated Systems

Advancements in technology have to a great extent enhanced tax administration. However, they have also or at the same time had a negative impact on the tax culture and as a result impacts negatively on compliance. This is moreso where there is dependence of systems working in other jurisdictions. Accordingly, each tax administration should maintain a degree of autonomy in designing its own computerization systems.

ESD provides enormous benefits in effectiveness and efficiency of tax collection. It simplifies and streamlines operations and creates cost effective administrations. However, compliance depends on a myriad of factors, which tend to cancel these merits.

There are risks associated with ESD. These include concerns of privacy, security, cost, equity and burden of change. The personnel risks include a changing work environment, volume of work and skill needs. As a result, there are always challenges and possibility of resistance, both internal and external.

The implementation of electronic and automated systems by KRA has been partially successful. The challenges have included lack of funding; resistance to change by existing personnel and clients; inadequate training of staff; system performance, security, unavailability and unreliability; hostility and negative attitude from sections of the clients; and the capacity of suppliers.

Indeed, the Kenyan experience, as it is elsewhere, clearly demonstrates that the successful introduction of new technologies requires consideration of the susceptibilities of existing staff and their resistance to change. All involved parties must therefore work together. The system should also be as simple as possible. 699

By KRA's own admission, ITMS, ETR and S2005S have all underperformed. This means that they have not achieved their objectives. The rules of results and relevance were not complied with.

However, every modern tax administration is expected to employ automated systems for the major processes. County tax administrators should therefore ensure that they start on this footing and as they grow they have reliable systems, with secure back-ups. A benchmark for the systems is necessary.

This study has observed that software applications designed for national level use are either faulty or do not reflect the needs of local tax offices. There is need for locally designed (or re-designed) systems that would take into consideration the "cultural" differences. Computer skills at local levels are also wanting and this should be taken into consideration.

7.2.4 Property Rates

The role of property rates is the generation of revenue to enable the county government to provide services to persons within its jurisdiction. Consequently, an effective property tax administration maximizes on revenues collected.

⁶⁹⁹ Bird, R. M. and E. M. Zolt (2008) *supra*, p. 11.

Property rates have hitherto been administered by local authorities established under the repealed Local Government Act and administered under the Valuation for Rating Act and the Rating Act. These statutes are still in force pending the enactment of alternative legislation notwithstanding the existence of some glaring contradictions with the current constitutional set up.

Property rates are very difficult to avoid. This probably explains the general success of the regime even when the local authorities did not have efficient systems for the collection.

For the proper administration of property rates, the relevant authority must have proper information and records. It requires correct cadastral data. There are cost implications on the assessment of the tax base and maintenance of cadastral data. However, there is no compliance expense on the part of the taxpayer as there is no requirement on his part for record keeping, filling of forms or calculations.

To have an effective property tax regime, the identification of the property and owner is crucial. A fiscal cadastre should have, as a minimum for each property, a description, defined boundaries, ownership, and value. Cadastral maps are essential in which all parcels should have unique numbers. The information should be kept updated.⁷⁰⁰

A county should have the proper information on the taxpayers. This must be reconciled with the provisions of Section 5(2)(d) of the National Land Commission Act which requires the National Land Commission to develop and maintain an effective land information management system at national and county levels.

Valuation is central to the administration of property taxes. Most jurisdictions require only a determination of the relative value of property and not an absolute value, making it possible to use techniques of mass assessment.

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⁷⁰⁰ See also Bird, R. M. & E. Slack (2002) *supra*, p. 28.

The choice between flat taxes and area-based taxes has to be made. In countries in transition, area-based systems are more widely used, as opposed to market-values based system. Whereas it may generally be argued that Kenya is in a transition to a new constitutional dispensation, it is not sufficient to make Kenya a transitional economy. As a result, value based systems would still be the suitable mode for property taxation in Kenya.

The Rates Clearance Certificate regime used in Kenya is capable of promoting compliance. This is notwithstanding that it has been held not to be particularly effective.

The question of the authority that conducts the valuation has to be determined. Property rates valuation and collection in Kenya has been done at the local level, similar to some other jurisdictions. In other jurisdictions, there is a mixture of either central valuation and central collection, central valuation and local collection, and local valuation and central collection.

As observed earlier, it breeds efficiency if a taxing authority has full control over its tax administration. Accordingly, whereas national legislation should provide for valuation, the counties are best placed to value and collect taxes within their jurisdictions. To avoid instances of unfair tax competition and tax exporting, national legislation should provide for mechanisms through which the national government can provide for tax rates' limits within which county governments should fix their rates.

There are three forms of rating used in Kenya. These are the area rate, an agricultural rental value rate and a site value rate or a site value rate in combination with an improvement rate. The most commonly used has been the unimproved site value rate.

National legislation may provide for standards of valuation. However, a decision has to be made whether the standards are to apply uniformly across all counties. The peculiar circumstances of the individual counties should be taken into consideration

in setting the standards. In light of Article 209(5) of the Constitution of Kenya that enjoins counties to ensure that their revenue-raising powers do not prejudice national interests, there is need for effective monitoring and evaluation of the various models.

A valuation roll is amenable to judicial review. As a consequence, the valuation officer must ensure that the determination of values is conducted fairly and justly.

The ratio of property tax to GDP is not the best measure of a successful property tax regime for two reasons. First, a computation for GDP in a county is somewhat problematic due to the requirement to collect the necessary data and also the fact that county boundaries are very fluid and it is not always easy to determine with certainty the fixed abode of every person. The reason for this is because a person may, for instance, reside in one county but has a business activity in the neighbouring county or even several counties. Secondly, GDP has not always been a very reliable source of data, especially at the subnational level.

The effective rate of property tax is therefore the better measure. Accordingly, the test of an effective property tax administration is represented as:

ERPT=TC/MV

as opposed to

X=PT/GDP.

7.2.5 Entertainment Taxes

It is not clear what entertainment tax entails. There is therefore uncertainty in its administration.

The only statute which directly deals with entertainment tax is the Entertainments Tax Act. The tax is collected by the District Commissioner. Though the Act still forms part of the law books, its continued application is in doubt. In any event, its

application would be unconstitutional as entertainment tax is now under the jurisdiction of counties.

Under the Tourism Act, the Minister for Finance may propose a tax. It is still not clear how this will be implemented.

The Betting, Lotteries and Gaming Act establishes the Betting Control and Licensing Board as the collector of taxes under it. Most of the activities licensed under this Act fall under the wider definition of the term entertainment. As such, the collector of the said taxes would constitutionally be the counties.

7.2.6 Other County Taxes

No legislation has been enacted to put into effect the provisions of Article 209(3)(c). Consequently, counties are yet to be authorised to levy any other tax except property rates and entertainment taxes.

As seen in Chapter 6, other taxes that counties may be authorized to administer include boat tax, motor vehicle tax, commercial and advertisement tax, tax on closing roads and streets, and tax on keeping animals. However, this is outside the scope of this study and as such no proposals relating thereto are made.

7.2.7 Tax Administration Reforms

Tax administration and tax structure need to be improved simultaneously in tax reforms as they are interconnected. Accordingly, an essential precondition for reform of tax administration is the simplification of a tax system. The relevant law should be easy to understand. This would be to ensure that it can be applied effectively even in low-compliance jurisdictions. Poorly conceived or complicated tax structures, such as those that would be open to diverse and contradictory interpretation, complicates the operating functions of the tax administration while a simple and transparent tax structure has a positive impact.⁷⁰¹

⁷⁰¹ Bejakovic, P. supra, p. 10.

Tax administration reform is not an easy and simple task as tax administration reflects a whole range of social and economic factors and conditions. These include the education and knowledge of staff, the distribution of income and the attitude regarding the authority of government.⁷⁰² It is also important to appreciate that tax administration reforms are highly political.⁷⁰³

The reform of tax administration is achievable. The results will, however, be bad if tax policy and tax administration are treated as independent phenomena.⁷⁰⁴

The reform of tax administration requires the simplification of the tax structure, establishing and accepting appropriate strategy that is adjustable to the moment, situation and conditions, and political resoluteness. Political interference can be an obstacle to efficient tax administration. Efficient tax administration and successful tax reform requires that tax payers have the right to know how their taxes are used. This reduces the possibility of "taxpayer alienation".

7.2.8 The Tax Culture

It has been observed that it is possible to discern a country-specific tax culture. When there is a clash between different cultures and divergent tax systems, the resultant disturbances are tax culture shocks and tax culture lags. Collective tax culture has a negative effect on the entire tax reform initiative. Whereas tax culture lag is almost inevitable, the degree of negative effects depends on the extent of conformity.

As noted earlier, symptoms of negative impact of tax culture have been observed in Kenya. These include the perception of taxpayer identification during the colonial era, and indeed, to date; the uptake of ESD; and even the concept of ARAs.

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⁷⁰²*Ibid*,p. 11.

⁷⁰³ Von Soest, C. (2008) *supra*, p. 42.

⁷⁰⁴Bejakovic, P. *supra*, p. 19.

⁷⁰⁵*Ibid*, pp. 19-20.

Whereas existing literature on tax culture is country-specific, it is in order to extend the applicable principles to be county-specific. Individual counties would be at different stages of sophistication, and as such different reform measures would impact on them differently. For instance, rural counties may not be at the same position of largely urban counties on the acceptance of ESD systems. Their conception of property for purposes of taxation may also vary.

Kenyans have not accepted a taxpaying "culture". Whereas in Chapter 2 we have underscored the importance of 'leading' law reform, it is usually unsustainable to just use laws to regulate behaviour. In any event, through history there has always been opposition to taxation. Accordingly, the better approach would be the use of taxpayer education services.⁷⁰⁶

7.2.9 Patriotism and Taxation

The question as to whether payment of taxes is a patriotic duty still remains unsettled. Some would argue that patriotism is irrelevant as the determination of one's taxes is a purely legal matter. This has its basis on the linkage between patriotism and anti-tax sentiment arising from the fact that the fight for liberty was also about resistance to taxes. This view is also strengthened when taxpayers feel they are overtaxed. ⁷⁰⁷

Most taxpayers in Kenya view the Kenyan tax system as unfair.⁷⁰⁸ It is not enough for a tax to merely satisfy technical assessments of ability to pay; it must feel fair to taxpayers. If it is not perceived as fair, it will not be acceptable. Conversely, a tax that is felt fair will be acceptable, even if it fails the technical standards of progressivity. It has been observed that value-based taxes on immovable property

⁷⁰⁶ Moyi, E. & E. Ronge (2006) *supra*, p. 1.

⁷⁰⁷ Lavoie, R (2001) "Patriotism and Taxation: The Tax Compliance Implications of the Tea Party Movement", *Loyola of Los Angeles Law Review*, Fall 2011 vol. 45: 39-86 at p. 42.

⁷⁰⁸ Lumumba, O. M., M. S. Wanjohi & O. Magutu (2010) *supra*, p. 119.

are a natural target for taxpayer dissatisfaction.⁷⁰⁹ It is easier to increase compliance if taxation is perceived to be fair and if tangible benefits can be seen.⁷¹⁰

There is need to strengthen the bond between taxpayers and the government. This should be done at both the national and subnational level. This would help in the growth of patriotism positively associated with taxation. This can be enhanced through structures that promote transparency and accountability in the use of public finance so that taxpayers can know that their taxes are put to good use.

If a "taxpaying ethos" is developed at the county level, this will lead to higher levels of compliance. If taxpayers feel alienated, the work of tax administrators become more difficult.

For a "taxpaying ethos" to develop, there is need to address the runaway corruption, both in fact and perception. Corruption is known to be a major impediment to political, economic and social development. It has a negative effect on administrative development and performance, economic efficiency, development of local initiative and enterprise, and indeed leads to other social ills such as crime, ethnicity and ethnic conflicts, and family related problems.⁷¹¹

7.2.10 Tax Administration and Human Rights

The administration of taxes must respect the rights and fundamental freedoms of taxpayers. Most importantly, and as seen in Chapter 6, Article 47 of the Constitution provides for fair administrative action.

Certain actions of tax administrators can be seen as derogations to protection of right to property. However, the derogations observed may be termed constitutional as the price to pay for living in a civilised and progressive society.

Counties must, however, observe the rights of their citizens.

⁷⁰⁹ Youngman, J. and J. Malme, *supra*, p. 15.

⁷¹⁰ Von Soest, C. (2008) *supra*, p. 42.

⁷¹¹ Mulinge, M. M. & G. N. Lesetedi (1998) *supra*, p. 16.

As seen in Chapter 3, the right to privacy may be limited within the law for the achievement of greater goals for the public good. However, this should not be liberally used to curtail freedoms. Certainty is a basic principle in taxation and therefore there is need to have mechanisms to determine the extent of the curtailment.

7.3 PROPOSALS

As seen in Chapter 1, a reform strategy must identify specific bottlenecks and formulate concrete measures. Key among these are taxpayer identification and registration, the process of making payments, the use of ICT, detection of defaulters and collection of arrears, the sanctions and penalty system, management and organisation, personnel and taxpayer services and publicity. The reform proposals made herein therefore attempt to address these among other factors.

7.3.1 REFORM FOR DEVELOPMENT

7.3.1.1 Tax administration for progress

As discussed in Chapter 2, law and development is meant to lead the way to progress through law reform. There is need to propose specific measures for attaining a better society from time to time.

A comprehensive fiscal policy requires a strong tax administration. Such a fiscal policy is fundamental if the government is to fulfil its responsibilities in the fight against poverty and the achievement of a fairer distribution of a nation's wealth.⁷¹²

The three kinds of law reform are applicable in the current situation. Through "tinkering", we appreciate the constitutional provisions relating to county taxation, and then seek ways of improving efficiency. Through "following", we have to interrogate the legal system and see whether it fits well with social change. For instance, we have to make a decision as to whether land in the counties, which is

⁷¹² Fakile, A. S., F. F. Adegbie & O. S. Faboyede (2014) *supra*, p. 92.

largely less than optimally used, should be taxed through the same systems as other land that is in commercial use. More importantly, we should place emphasis on "leading" law reform so that it can be an instrument of development. For instance, the system used to impose and administer tax on property may compel land owners to utilize the land more effectively.

Tax modernization and reform was first conceived in Sessional Paper No. 10 of 1965 on *African Socialism and its application to Planning in Kenya*. The implementation foundation was then laid out in Sessional Paper No. 1 of 1986 on *Economic Management for Renewed Growth*. *Kenya Vision 2030* does not provide specific strategies for tax administration reform. Even if it did, it would not be of much use to county taxation as it pre-dates the Constitution of Kenya, 2010.

There is therefore need for the formulation of a policy paper giving guidelines and principles that county governments would need to observe in the formulation of their laws as relating to tax administration (and tax substance, too). This would especially give the much needed guidance to counties on the concepts and principles outlined in Article 209(5) of the Constitution to ensure that county tax legislation does not prejudice national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labour.

Whereas this study also proposes the enactment of national legislation to bind counties in respect of their taxing powers, a policy paper stands in good stead in this respect as it is better used to explain principles that cannot be adequately and objectively defined in legislation. These include the principles mentioned in Article 209(5) of the Constitution.

7.3.1.2 Identification and Registration

Identification and registration of taxpayers met resistance in Kenya, as has also been observed everywhere else. This is mainly because of the initial purpose for the identification and registration of taxpayers in colonial Kenya. However, the uptake

has risen especially because of the impossibility of carrying out monetarized transactions in Kenya without a PIN.

A taxpayer registration system is important for the administration of county taxes. However, as observed, there is no reason for individual counties to have parallel registration systems. The reason for this is two-fold. First, the inventory of county taxes is generally not taxpayer-based but rather subject-based. This means that where property rates are imposed, they are imposed on the property and not the individual owner; meaning that if a taxpayer has more than one property, the various properties will be taxed separately. Accordingly, property registration is more useful than taxpayer registration. Similarly, where entertainment tax is imposed, it is on a particular event and not, strictly speaking, on the taxpayer.

Second, the PIN system has wide coverage in the country and it would be unnecessary to duplicate the system.

Counties should therefore have access to the PIN system operated by KRA. The question would be as to the extent of access. This would depend on the extent of information to be shared. It is however clear that the county governments should not have the facilities to input into the system but only access to information.

This position should be espoused in the policy paper proposed earlier and given legislative force through the proposed national legislation. The national legislation should enjoin KRA with a duty to share information with county tax administrations.

The proposed national legislation should contain provisions providing for the following:

a. The personal identification number required under section 132 of the Income Tax Act shall be the personal identification number required under any county legislation requiring a personal identification number, and shall be required to be included in the returns and any other statements made under any county legislation.

- b. 1) The KRA shall provide to any county government, upon request, any information held by it in respect of any taxpayer, except as provided in this Act.
 - 2) Where KRA is unable to comply with the request provided for in subsection 1 or for good reason it is of the opinion that the said information should not be provided, it shall inform the county government in writing within 14 days of the request.
 - 3) Where a county government is of the opinion that it has been unduly denied the requested information under the provisions of subsection (2) it shall refer the dispute to the Disputes Tribunal established under this Act.
- c. Where in this Act reference is made to a personal identification number or a personal identification number system, the same shall also be construed to refer to its electronic form or a system using electronic personal identification number.

7.3.1.3 The Tax Collection Agency

It has been observed that the establishment of ARAs for counties is not a viable option. This is because the demerits outweigh any potential benefits. Their tax bases are also too restricted to require a fully fledged authority.

The administration of county taxes should be managed by the County Treasury, headed by the County Executive Committee Member for Finance. The Constitution provides a basis for this when it establishes a County Revenue Fund for each county into which all county government revenue is to be paid.⁷¹³ This County Revenue Fund is administered by the County Treasury.⁷¹⁴

7.3.1.4 Valuation

Valuation is considered as the most difficult in property tax systems. For proper valuation to be undertaken, cadastral data is required. In Kenya, this data is maintained by the Ministry responsible for lands and the National Land Commission.

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⁷¹³ Article 207 of the Constitution of Kenya, 2010.

⁷¹⁴ Section 109, Public Finance Management Act, Act No. 18 of 2012.

Indeed Section 5(2)(d) of the National Land Commission Act requires the National Land Commission to develop and maintain an effective land information management system at the national and county levels. There is therefore need for co-operation between the national government and the county government for the sharing of this information. However, in the long term counties must prepare their own comprehensive registers. There is therefore need for county legislation providing for the registration of all land parcels.

Valuation does not require an absolute market value but a determination of the relative value. It is therefore possible to conduct mass assessments.

The form of rating should also be determined. The property in most counties in Kenya is a mixture of urban and rural properties. Accordingly, a uniform system of rating may not be suitable across the board. This study proposes a combination of the unimproved site value rate and an improvement rate that would be a tax on buildings based on the reproduction cost of the building. However, small-holder agricultural land should be exempt from rates, so as not to prejudice national interest. These small-holder agricultural lands should, however, be within the minimum acreage provided by any national legislation to prevent unlimited parcelization of land that would lead to uneconomical use of land. These proposals should form the subject of national legislation.

The county legislation on property rates should therefore provide for the following:

- a. All owners of land must be required to register their properties with the county government.
- b. All owners of land and holders of leases exceeding six (6) years are the taxable persons.
- c. The standard for valuation is the relative value of the land or building.
- d. The methods of valuation to be used are the unimproved site value rate and the improvement rate, where applicable.
- e. The valuations will form a valuation roll on which a rate struck will be passed by the County Assembly.

- f. The valuation is to be conducted at least once every ten (10) years; but any new transactions registered with the county government during the intervening period may be used for ascribing values.
- g. The County Treasury shall have a valuation department to undertake valuation of properties.
- h. The County Treasury shall be responsible for county tax administration.
- i. Every taxpayer has a right to appeal to the Valuation Court set up on any issue in respect of valuation of property.
- j. In the event of default, the Valuation Court should make the necessary orders which can be registered at a magistrate's court for execution.

The foregoing proposals are without prejudice to the provisions of Article 67(2)(g) of the Constitution and Section 5(2)(g) of the National Land Commission Act which provides for the National Land Commission to assess tax on land and premiums on immovable property in any area designated by law.

7.3.1.5 Privatization

Counties should consider the privatization of some functions in tax administration. These functions have been identified hereunder. This would present some opportunities. It is also expected that there will be challenges in its implementation.

Privatization is under consideration because there is generally dissatisfaction with tax administration and privatization can bring efficiency into the system which would work to the benefit of the taxpayer. Privatization, *per se*, is not the panacea, but how it is implemented plays a big role.⁷¹⁵

Tax administration privatization is also advantageous because it addresses the problems of corruption, low wages levels in the public service and political patronage.⁷¹⁶

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⁷¹⁵ Byrne, P.D. (n.d) "Privatization in the Area of Tax Administration: An Overview," pp. 1-2.

⁷¹⁶ *Ibid*, p. 3.

It is proposed that the following functions can be privatized.

- a. Taxpayers should be required to prepare their own returns. This also enhances voluntary compliance. This would be applicable for both property rates and entertainment taxes. This would play a great role in improving the tax culture as the taxpayers would be actively involved.
- b. The county government should authorize banks to accept tax payments and returns. This is akin to the system used by KRA where banks receive VAT returns and payments on its behalf. This is to a great extent dependent on an effective ICT system interconnecting banks with the county government's financial system.
- c. Property valuation should also be contracted to private firms. There should also be a self-assessment by the taxpayer. This would reduce costs on the part of the government.
- d. The tax administration should also consider the privatization of certification of returns. This would reduce errors and also save time. This would be done through a county government appointing a panel of tax returns preparers, such as certified public accountants, to whom taxpayers would go for certification. Monitoring of the tax preparers would be done through an assessment of the errors arising from each of them.
- e. Counties should also privatize the taxpayer audit function. This may bring confidentiality issues but it can be overcome through legislation. This should be an interim measure due to confidentiality concerns.⁷¹⁷

Privatization of revenue collection is envisaged by Section 160 of the Public Finance Management Act whereby it empowers the County Executive Committee member for finance to appoint a collection agent. Specific procedures for this ought to be spelt out in national and county legislation.

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⁷¹⁷ *Ibid*, pp. 4-16.

7.3.1.6 Technology

Technological advancement is an important aspect of tax administration reform. It is therefore inevitably a factor in county tax administration reform. It must, however, be done in such a manner as to harness its positive aspects.

There is need for the introduction of an ICT system at the counties for purposes of taxpayer identification and all the other functions up to the collection of the tax. The system must, however, be designed for the local needs of the particular county. It should, however, be compatible with the KRA system to enable the county to plug into the system once the same is allowed.

The introduction of the ICT system must also appreciate the human element. All persons who would be in the implementation chain must be involved from the onset. Political will should also be cultivated to avoid any obstacles.

7.3.2 REFORM FOR SOCIAL ENGINEERING

7.3.2.1 The Social Interest

In addition to raising of revenue (and sometimes even without raising any revenue) a tax may be expected to advance certain social objectives. Accordingly, a tax statute must be administered in the manner that advances the major social interest as expressly or impliedly provided by the statute. It is expected to regulate social behaviour to ensure that the conduct of everybody is consistent with the overall plans of the society.

The administration of property rates, entertainment taxes and other county taxes must therefore advance specific social objectives. Key among these is the maintenance of social fabric to protect the family which is basic social unit. Accordingly, no tax administrative action should be undertaken to interfere with family inheritance. As such, no taxes should attach to the transmission of land

through inheritance or gift *inter vivos*. This would ensure a smooth transmission of property from one generation to the other.

Further mechanisms should be established to prevent the execution of attachment orders in respect of ancestral land in default of payment of rates. The effect of such an action would be to leave some members of the population landless and destitute.

7.3.2.2 Tax Culture

Tax reforms have always been politically challenging. One of the reasons has been tax-cultural considerations. This study, therefore, takes the view that these considerations are important for the implementation of a successful tax administration strategy.⁷¹⁸

Whereas the term "tax culture" has mainly been used in respect of a national tax culture, this can also be extended to a certain degree to a county tax culture. The concept of a 'right' taxation is dependent on time and location. This is more so real when tax mentality is deemed to include the attitudes and the patterns of behaviour which the tax-paying citizens hold against, or with, the tax and the state. In that form, the components would include tax morale and tax discipline.⁷¹⁹

As noted earlier, most of the tax reforms in Kenya, like in most of sub-Saharan Africa have been steered and influenced by international organizations such as the World Bank and the IMF. Unfortunately, it is only recently that they appreciated the full impact of tax culture on a successful tax reform effort. Accordingly, this has not been mainstreamed in the tax reform propositions. It is therefore necessary to conduct tax culture audits.⁷²⁰

More importantly, there should be an appreciation of the obtaining variances in tax culture across the counties. As the presentation of collective tax culture shocks

⁷¹⁸ Nerre, B. (2008) *supra*, p. 153.

⁷¹⁹*ibid*, p. 155.

⁷²⁰*Ibid*, p. 163.

should be a normative criterion for sound national tax policies, so should it be for sound county tax policies.

These proposals should be captured in a national policy document to act as a guide in the formulation of county tax policies and county tax legislation.

7.3.2.3 Patriotism

As seen earlier, tax administration in Kenya has faced challenges as a result of the colonial history of taxation, giving it an imperialist tag. There is therefore need to disentangle patriotism from anti-tax history so that the country's taxpaying ethos can change.

This research proposes that deliberate awareness programmes should be initiated to propagate the patriotism element in tax-payers. This would require the espousing of KRA's slogan, "kulipa ushuru ni kujitegemea"⁷²¹ whose literal meaning is that paying taxes brings about self-sustenance. This should go further to explain that it is an act of patriotism to pursue self-sustenance.

Tax education should be introduced in schools with a view to educating the young on the role and significance of taxes. This would be a means of enhancing taxpayer consciousness. The strategy used should have both medium and long-term perspectives.⁷²²

Tax authorities should explore and maintain close relationships with taxpayers. This would bring more people into the tax net and encourage compliance.⁷²³

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A keen observer will remember that the original KRA slogan was "*kulipa ushuru ni kulinda uhuru*" which literally means that paying taxes is safeguarding your independence (or freedom), which is a strong patriotic slogan. This slogan was changed to the current one in unexplained circumstances. However, one may notice that at the time this was done, the 4th President of the Republic of Kenya, Uhuru Kenyatta, was the Minister for Finance (the Ministry responsible for KRA), with an eye on the presidency and as such the slogan could mischievously be misinterpreted.

⁷²² Fakile, A. S., F. F. Adegbie & O. S. Faboyede (2014) *supra*, p 105. ⁷²³ *Ibid*.

Counties should also initiate programmes to inculcate tax-paying ethos within their jurisdiction.

One of the tools that can be used to make taxpayers patriotic enough to be motivated to pay taxes is by inculcating a system of transparency and accountability in financial management within the counties so that the taxpayers can feel that their taxes are used for the intended purposes.

It has been recognized that new approaches are necessary to promote compliance. These include promoting taxpayer education and promoting a taxpayer 'code of ethics'. The county tax administration should therefore act as facilitators to enable the taxpayers perform their patriotic duty.

7.3.2.4 Human Resources

The human element is a key cog in tax administration. The tax employees perform the tax administrative procedures and as such determine whether the system functions in an efficient and effective manner.⁷²⁵

The effective and efficient administration of county taxes requires availability and retention of qualified officials, with the right attitude and behaviours. Employee attitudes affect customer satisfaction and accordingly influence the performance of the organization.⁷²⁶

County governments must therefore take deliberate action to recruit qualified staff and have workable programmes for their retention. This would lead to customer satisfaction and hence higher compliances levels.

Alm, J. and J. Martinez-Vasquez (2003) "Institutions, Paradigms and tax Evasion in Developing and Transition Countries," in Alm, J. 4 & J. Martinez-Vazquez (2003) *Public Finance in Developing and Transitional Countries* 146- 162 at p. 155.

⁷²⁵ Mansor, M. (2010) *supra*, p. 21.

⁷²⁶*ibid*, pp. 21-22.

The attitude and behaviour of county tax officials should be addressed. This can be through, among other ways, providing incentives and regular appraisals of their performance.

It has been suggested in this study that counties should also establish continuous professional development programmes for staff both to optimize their productivity and also as a way of constant realigning goal and vision.

7.3.3 ADDRESSING THE FALSE PARADIGM MODEL

Awareness of the false paradigm makes the actions of people and institutions more attuned towards the actual needs and wants of their countries. This is because it brings to light the misguided actions of policy makers, scholars and aid agencies. It therefore becomes a wake-up call.⁷²⁷

7.3.3.1 Autochthony

It has been argued in this study that a number of past administration reform efforts have been driven by external forces and factors. This has in some instances led to faulty and inappropriate action.

Donor assistance in tax administration in developing countries is bound to increase. This is in terms of both financial and technical support. While this thesis is not opposed to such assistance in principle, the reform measures (meaning, the technical aspects) should largely be locally driven. 728

There is need for autochthonous reform efforts. It must be appreciated that globalization notwithstanding, taxation is still largely a local issue. The use of foreign experts in designing tax systems inevitably leads to a tax system with a patchwork character. This results in a continuous need to legislate new tax changes.

⁷²⁷ Weller, C. (2012) "Neocolonial dependence model and the false paradigm: useful for explaining development in Haiti and the Dominican Republic?" Indian Journal of Economics and Business, March 1, 2012, p. 4. ⁷²⁸ Fakile, A. S., F. F. Adegbie & O. S. Faboyede (2014) *supra*, p. 92. 217

As noted earlier, there is no common law of taxation. Tax law is strictly statutory. Accordingly, whereas lessons can be learnt from other jurisdictions, the guiding principle should be that the local conditions must be examined before the enactment and implementation of any tax administration tool.

If the foregoing is the guiding principle, it will therefore be possible over time to discern a clear reform methodology.

7.3.3.2 Inter-county co-operation and assistance

To ensure effective tax administration, co-operation and exchange of information is necessary. This needs to be both horizontal (inter-county) and vertical (counties and national government or national government agencies). This can take other form of coordination of identification and registration of taxpayers and the exchange of such information: the use of a single taxpayer identification number: the exchange of audit and other compliance data; locating national and county taxpayer services offices as close together as possible; and coordinating payment mechanisms between national and county taxes as much as is possible.⁷²⁹

It has been observed that cooperation leads to some reduction in administrative autonomy. This can be cured by making co-operation optional. This will enable the various units take it up only when it is beneficial to them.⁷³⁰

KRA and the county tax departments should have information exchange agreements that would provide counties with, among others, return filing data, third-party reports⁷³¹ and audit reports. The agreements should contain strong confidentiality safeguards.⁷³²

⁷³¹ For instance, from banks, employers, insurance companies, etc.

⁷²⁹ Mikesell, J. L. (2003) *supra*, p. 30.

 $^{^{730}}ibid.$

⁷³² Mikesell, J. L. (2003) *supra*, p. 41.

The Kenya Revenue Authority Act should be amended to provide for the exchange of information between KRA and the counties. The Act should also include, as a schedule, an information sharing and exchange agreement to manage the relationship.

Collaboration between KRA and county tax departments should also be on taxpayer education programmes.⁷³³

County tax departments should also benefit from KRA's long experience through training of county staff. This would develop specialized expertise at the county level.⁷³⁴

Co-operation between counties may also enhance tax administration especially due to economies of scale and pooling of expertise. It is proposed that counties be encouraged to operate inter-county agencies to carry out same specialized aspects of administration such as valuation of property and auditing. This should be enacted into law through national legislation in the Counties Revenue Administration Act proposed herein.

Indeed Section 187 of the Public Finance Management Act⁷³⁵ provides a consultation and cooperation mechanism through the Intergovernmental Budget and Economic Council.

7.3.4 BENCHMARKING METHODOLOGIES AND STRATEGY FORMULATION

The guiding principles in the formulation of benchmarking are the achievement of a favourable tax gap or tax collection efficiency ratio in the range of 10-20%; equity between taxpayers; a positive effect on economic stability both within the counties and nationally.

⁷³³*ibid*.

⁷³⁴*ibid*.

⁷³⁵ Act No. 18 of 2012.

The benchmarks against which a county tax administration must be measured (and the tests to be applied) include the following:

a. The system of registration and identification of taxpayers or the subject matter.

Test: Is there a reliable and effective system?

b. The institutional structure of tax administration.

Test: Are the institutions properly established by law and are there mechanisms to harness the synergy?

c. The system of receipts and collections of taxes.

Test: Does the institutional structure allow for an effective and efficient system of receipt and collection of taxes?

d. The enforcement mechanism.

Test: Are there legally established enforcement mechanisms?

e. The existence of deliberate taxpayer services, including taxpayer education, taxpayer assistance and facilitation of voluntary compliance.

Test: Is there an institutional framework for taxpayer services?

f. The availability of an effective and efficient dispute resolution mechanism.

Test: Is there an effective and efficient dispute resolution mechanism?

g. A system of monitoring and evaluation through audits.

Test: Does the institutional framework provide for a system of monitoring and evaluation?

h. The existence of reliable ICT systems.

Test: Are the ICT systems reliable? Do they complement the tax administration?

i. Certainty in the legal framework.

Test: Does the legal framework reduce to the fullest extent possible the discretion of tax administrators?

j. A reasonable code of ethics for tax administrators and a service charter.

Test: Are there internal systems to manage the tax administrators?

k. The provision of adequate resources to the administration.

Test: Is the tax administration sufficiently resourced to enable it carry out its mandate?

The availability of a qualified and motivated workforce.

Test: Are there systems to ensure that the workforce is qualified and motivated, and remains so?

m. A system of vertical and horizontal co-operation and information exchange.

Test: Is there an institutional framework for co-operation?

The goals of modelling a strategy for county tax administration are both to put into effect the requirements of the Constitution and to have a sustainable and efficient administration system that would achieve its objectives. As noted in the preceding Chapters, cost is important in determining the approach to use. It is also important to use the most efficient method that would yield the highest revenue. The main objective of subnational taxes is to raise revenue to give the subnational governments fiscal independence. However, the raising of revenue should be done after taking into consideration factors that would affect the overall impact on the taxpayers.

It may not be possible to legislate political commitment to the reform effort, notwithstanding that it is an important factor to the success or otherwise of the effort. It is therefore necessary that the laws enacted towards this effort are certain and specific so as to reduce to the minimum any discretion that may be in the hands of political leaders.

A simple tax system reduces compliance costs and also encourages voluntary compliance. Certainty in the tax legislation is one way of simplifying a tax system.

By their very nature, the taxes under the ambit of county governments are likely to impact on taxpayers residing or having economic activities in different jurisdictions. For instance, a taxpayer may own property in two or more jurisdictions or may have entertainment business in several counties. Some uniformity and harmony in application is therefore necessary. The formulation of the proposed national Counties Revenue Administration Act and a national policy paper are geared towards this goal.

Counties do not have similar resources. Accordingly, and as seen earlier, the best approach would be to design a system that can be acceptably implemented by even the counties with the weakest administration.

7.3.5 THE IMPLEMENTATION MATRIX

7.3.5.1 The Constitution of Kenya, 2010

The Constitution should be amended with a view to providing a definition of the term 'property rates' in Article 260. This would cure the absurdity caused by the definition of 'property' under that Article to include items that are clearly not intended to be subjected to property rates by counties.

The amendment to Article 260 by way of addition should take the following form:-

"property rates" mean any tax imposed on land, or permanent fixtures on, or improvements to, land, or any premium attached thereto.'

This proposal is based on the fact that the Constitution has an interpretation clause. If the said clause was not there, the better approach would have been to relegate the definition of terms to legislation.

There is also need to amend Article 67(2)(g) by way of a proviso to underscore the unfettered power of counties to levy property rates in their areas of jurisdiction. The amended Article should take the following form:-

- "67(2) The functions of the National Land Commission are
 - (g) to assess tax on land and premiums on immovable property in any area designated by law;

Provided that nothing contained herein shall be construed to fetter or otherwise affect the powers of a county government to impose, assess and collect property rates in its area of jurisdiction."

7.3.5.2 National Legislation

To guide the administration of county taxes, legislation should be enacted in the manner provided under Articles 109 to 113 of the Constitution by Parliament. This Act should incorporate the proposals made herein. A Counties Revenue Administration Act is accordingly proposed. This Act should include the Inter-Counties Tax Cooperation and Assistance Agreement proposed in part 6.3.3 as a schedule.

This Act should address, inter alia, the following matters:

- a. The mode of determining compliance with Article 209(5) of the Constitution of Kenya, 2010.
- b. The extent of the power of the County Executive Committee member for finance to waive or vary tax, fees or charges pursuant to section 159(c) of the Public Finance Management Act.
- c. The setting of tax rate limits within which counties should set their rates.
- d. The establishment of a dispute resolution mechanism through a tribunal, for the resolution of disputes between the national government and a county government and inter-county disputes.

The Kenya Revenue Authority Act should be amended to provide for the following:

- a. The exchange and sharing of information between KRA and the counties' tax departments; and for the relevant Tax Information Sharing and Exchange Agreement.
- b. The possible contracting of KRA to administer revenue on behalf of counties. This would harmonise the Act with the provisions of Section 160 of the Public Finance Management Act.⁷³⁶

⁷³⁶ Section 160 provides:

The County Executive Committee member for finance may authorize the Kenya Revenue Authority or appoint a collection agent to be a collector of county government revenue for the purposes of this Part on such terms and conditions as may be agreed in writing in accordance with the regulations.

7.3.5.3 National Policy Paper

As suggested herein before, the national government should formulate a policy to guide counties in the implementation of their taxation and other revenue raising powers. Of special concern to this paper would be the expounding of the concept of national interest as provided in Article 209 (5) of the Constitution.

The policy paper should incorporate model legislation on property taxation and one on entertainment taxes which can be adopted by the counties to fit their peculiar conditions.

7.3.5.4 County Legislation

County governments should enact legislation with a view to providing systems for the administration of taxes and other revenues. In particular, the counties should enact legislation to address the following issues:

- a. To effect the implementation of Section 104⁷³⁷ of the Public Finance Management Act⁷³⁸ for the purpose of putting in place mechanisms to raise revenue and resources.
- b. To guide the County Public Service Board in establishing offices for the purposes of tax administration pursuant to its power under Section 59 (1) of the County Government Act⁷³⁹ and guide the process under Section 60 thereto.

⁷³⁷ Section 104 provides: "(1) Subject to the Constitution, a County Treasury shall monitor, evaluate and oversee the management of public finances and economic affairs of the county government including-

⁽a) developing and implementing financial and economic policies in the county;

⁽b) preparing the annual budget for the county and co-ordinating the preparation of estimates of revenue and expenditure of the county government;

⁽c) co-ordinating the implementation of the budget of the county government;

⁽d) mobilizing resources for funding the budgetary requirements of the county government and putting in place mechanisms to raise revenue and resources;"

⁷³⁸ Act No. 18 of 2012.

⁷³⁹ Act No. 17 of 2012.

- c. To provide for the identification and registration of properties subject to property rates, their valuation, the preparation of a valuation roll, a valuation court, the collection and payment of rates and execution in the event of default.
- d. To provide for the collection and payment of entertainment tax.
- e. To provide for the administration of any other tax that may be authorized by an Act of Parliament under Article 209 (3) (c). 740

The foregoing may require the enactment of multiple county legislation. It is proposed that counties enact the following Acts:

- i. The Revenue Administration Act (to cover a. and b. above).
- ii. The Rating Act (to cover c. above). This should largely take the form of a combination of the Valuation for Rating Act and the Rating Act, as they currently exist under national legislation.
- iii. The Collection of Entertainment and Other Taxes Act (to cover d. and e. above).

Towards achieving the foregoing, counties should adopt to the largest extent possible the model legislation incorporated in the National Policy Paper.

7.4 CONCLUSION

This research sought to prove three hypotheses as follows. First, the Personal Identification Number (PIN) used at the national level by the Kenya Revenue Authority (KRA) is not suitable for the administration of county taxes in Kenya. Second, the concept of Autonomous Revenue Authorities (ARAs) is not suitable for the administration of county taxes in Kenya. Third, the electronic and automated systems in use by the Kenya Revenue Authority (KRA) are not suitable for the administration of county taxes in Kenya.

The first hypothesis was discredited by the research findings. Taxpayer identification and registration is an important tax administration tool. The existing PIN system

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⁷⁴⁰ Article 209 (3) (c) provides: "(3) A county may impose –

⁽c) any other tax that it is authorized to impose by an Act of Parliament."

managed by KRA is fairly successful. The same system is applicable and suitable for the administration of county taxes. Mechanisms are necessary to enable counties to plug into the system for purposes of their tax administration.

The second hypothesis was supported by the study. The concept of Autonomous Revenue Authorities on which KRA is based has had a mixture of measured success and apparent failure to achieve certain objects. Whereas it may be suitable for national revenue administration, the concept is not suitable for county tax administration. Consequently, administration of county taxes should be conducted through the mainstream county public service.

The third hypothesis obtained mixed results. Whereas the research findings supported the use of electronic and automated systems, specific systems are needed for county tax administration. The electronic and automation systems introduced over time by KRA have had their failures and successes. The specific systems studied here are not specifically applicable to county taxes. Whereas it is clear that electronic and automation systems are necessary for county tax administration, there is need to develop autochthonous systems designed with the particular society in mind. The users within the tax collection agency should be involved in the entire acquisition and roll-over process to avoid failures associated with resistance to change.

The various tax administration reforms formulated in Kenya have been generally haphazard. Whereas some have achieved the envisaged results, others have failed, requiring continuous changes and upgrading.

The tax administration reform process in Kenya has not brought about any discernible rules or guidelines that can be used as benchmarks to guide future tax administration reforms.

Tax laws and tax policy are as good as the tax administration. To achieve the intended development goals through devolution in Kenya, there is need to have an effective and efficient county tax administration.

This can be achieved through the implementation of the proposals made herein. The specific proposals are as hereunder.

- A. The amendment of the following Articles of the Constitution of Kenya, 2010.
 - Article 260.
 - ii. Article 67(2)(q).
- B. The repeal of the following Acts of Parliament.
 - i. The Entertainments Tax Act, Chapter 470 of the Laws of Kenya.
 - ii. The Valuation for Rating Act, Chapter 266 of the Laws of Kenya.
 - iii. The Rating Act, Chapter 267 of the Laws of Kenya.
- C. The amendment of the following Acts of Parliament
 - i. The Kenya Revenue Authority Act, Chapter 469 of the Laws of Kenya.
 - ii. The Betting, Lotteries and Gaming Act, Chapter 131 of the Laws of Kenya.
 - iii. The Income Tax Act, Chapter 470 of the Laws of Kenya.
 - iv. The National Land Commission Act, Act No. 5 of 2012.
- D. The enactment of the following Acts of Parliament.
 - i. The Counties Revenue Administration Act.
- E. The enactment of the following county legislation.
 - i. The Revenue Administration Act.
 - ii. The Rating Act.
 - iii. The Collection of Entertainment and Other Taxes Act.
- F. The formulation of a national policy on county taxes.

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<u>APPENDICES</u>

APPENDIX 1

QUESTIONNAIRE FOR OFFICERS OF KENYA REVENUE AUTHORITY (KRA)

INTRODUCTION

My name is Njaramba Gichuki. I am a Doctor of Philosophy (PhD) candidate at the University of Nairobi School of Law. I am undertaking research towards a thesis entitled "Tax Administration Reforms in Kenya: Identifying Lessons to Model a Strategy for Sustainable Administration of County Taxes".

To assist in my research, I request that you spare some time to answer the questions in this questionnaire. Your responses will be treated with utmost confidentiality and used only for the intended purpose.

PA	ART A
Na	ame (optional):
Po	sition held:
De	epartment:
Pr	evious positions held:
PA	ART B
1	Identify the various tax administration reform initiatives undertaken by the Kenya
	Revenue Authority.

2	What is the impact of the use of the Personal Identification Number (PIN) in the
_	
	collection of taxes in Kenya?
3	How has the autonomy of the KRA enabled administration of taxes in Kenya?
	,
4	In your opinion, which would be more effective: a consolidated administration of
	taxes by KRA or independent departments collecting the different taxes? Justify

5		e various electronic and automated tax administration systems (Electronic
	Tax F	Registers (ETRs), Simba 2005 System (S2005S), Integrated Tax
	Mana	gement System (ITMS), etc.), please explain their effectiveness and the
	challe	enges faced in their implementation.
	a)	Electronic Tax Register
	b)	Simba 2005 System
	c)	Integrated Tax Management System
	d)	Others
	,	

6	In your opinion, what is the overall success rate of the various tax administration reform measures? (Tick one)
	Excellent
	Good
	Average
	Poor
	Very Poor
7	Has KRA come up with rules or guidelines to guide future tax administration reforms?
8	Are you aware of any reform measures taken or proposed by the KRA to guide tax administration in the counties?

9	Make proposals for modeling a sustainable system of administration of county taxes.

THANK YOU

APPENDIX 2 QUESTIONNAIRE FOR TAXPAYERS

INTRODUCTION

My name is Njaramba Gichuki. I am a Doctor of Philosophy (PhD) candidate at the University of Nairobi School of Law. I am undertaking research towards a thesis entitled "Tax Administration Reforms in Kenya: Identifying Lessons to Model a Strategy for Sustainable Administration of County Taxes".

To assist in my research, I request that you spare some time to answer the questions in this questionnaire. Your responses will be treated with utmost confidentiality and used only for the intended purpose.

PART A
Name (optional):
Individual/Corporate or business (Tick one)
From the following list, identify by ticking the taxes which you are subject to or you
have paid at one time or the other:
Income Tax
Value Added Tax
Customs Duty
Land Rates
Others (specify)

PART B

- 1. Do you have a Personal Identification Number (PIN) for purposes of payment of taxes? Yes/No
- 2. How does the possession of a PIN help you in the discharge of your tax obligations?

3.	How efficient is the Kenya Revenue Authority (KRA) in the discharge of its
	mandate? (Tick one)
	Poor
	Fair
	Good
	Excellent
4.	In your opinion, would you rather deal with the KRA for all your tax issues or
	separate and independent departments for each of the taxes eg. Income Tax
	Department, VAT Department, etc.? Why?

b. What wer	e the challenges	of implemen	ting ETR?		
c. Do you th	ink the ETR is ar	n effective tax	collection s	system?	
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					effecti

5. For corporate/business taxpayers:

•	For taxpayers who have paid customs duty:
	a) Have you used the electronic system/Simba 2005 System? Yes/No
	b) How efficient is it?
	c) What challenges did you encounter in using the S2005S?
	o, commence of the control of the co
	d) How can the collection of customs duty be made more efficient?

7.	In your opinion, what are the measures that should be taken to ensure that tax
	collection is effective?

THANK YOU

APPENDIX 3 QUESTIONNAIRE FOR TAX PROFESSIONALS

INTRODUCTION

My name is Njaramba Gichuki. I am a Doctor of Philosophy (PhD) candidate at the University of Nairobi School of Law. I am undertaking research towards a thesis entitled "Tax Administration Reforms in Kenya: Identifying Lessons to Model a Strategy for Sustainable Administration of County Taxes".

To assist in my research, I request that you spare some time to answer the questions in this questionnaire. Your responses will be treated with utmost confidentiality and used only for the intended purpose.

confidentiality and used only for the intended purpose.
PART A
Name (optional):
Employer/Organization:
Position held:
Previous positions held:
PART B
1. Highlight the impact of the Personal Identification Number (PIN) to efficient tax
collection.

2. In your opinion, should the PIN be used only for tax administration purposes or should it be used in accessing other government services? Explain

3.	Give your opinion as to whether tax administration became more efficient with
	the creation of the Kenya Revenue Authority (KRA) and the merging of the
	various tax departments.
4.	Give your opinion on the effectiveness of the following tax administration
	tools:
	a. Electronic Tax Register (ETR)

h	Simbo 2005 Systom (\$2005\$)
υ.	Simba 2005 System (S2005S)
c.	Integrated Tax Management System (ITMS)
	opose ways of modeling an effective system for the administration of county kes in Kenya.

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THANK YOU