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# NATIONAL TAX POLICY

*Sessional Paper No. 02 of 2023*

**National Tax Policy**  
*Sessional Paper No. 02 of 2023*

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## FOREWORD

The National Tax Policy is part of the Government's efforts to enhance predictability and transparency in tax policies. The Policy is underpinned on the Government's commitment to address the challenges that have faced the Kenyan tax system for a long time. As such this National Tax Policy identifies and analyses the challenges of the current tax regime and sets out broad policy guidelines to address these challenges thereby forming a basis for tax reforms and review of existing tax legislation. This is critical in nurturing a conducive environment for both local and foreign investors.

The Policy is aligned to the Fourth Medium-Term Plan (2023-2027) of the Kenya Vision 2030 that prioritizes implementation of economic recovery strategies under the Government's Bottom-Up Economic Transformation Agenda (BETA). BETA focuses on interventions that reduce cost of living; increase employment; incentivize investment and production; achieve more equitable distribution of income; enhance social security; expand tax base; and increase foreign exchange earnings.

The Policy is developed against a background of tight fiscal space occasioned by emerging expenditure pressures arising from drought related expenditures and external shocks, and financing constraints due to tight liquidity conditions. At the same time, revenue collection, as a share of Gross Domestic Product (GDP) continues to decline. This is attributed to various challenges, among them; increase in tax incentives, low tax compliance, continued effects of COVID-19 pandemic, growth of the informal sector and increased use of technology in contemporary business models, both of which are difficult to tax.

The Policy guidelines outlined to mitigate against the challenges affecting revenue collection, include: expanding the tax base so as to enhance fairness and equity in the tax system; embracing international best practice in tax administration; creating certainty and predictability of tax rates and tax bases; enhancing tax compliance; promoting investments; and reducing tax expenditure to minimize market distortions and reduce pressure for tax refunds. The Policy also seeks to reorient provision of tax incentives through the development of a framework for granting tax incentives that will ensure the incentives are time bound and growth oriented.

The implementation of the interventions highlighted in this Policy will be done through the Medium Term Revenue Strategy (MTRS). This is expected to reverse the decline in ordinary revenue collection as a share of GDP, which has been declining from 18.1 percent in the FY 2013/14 to 15.1 percent in the FY 2021/22, to the desired East African Community's (EAC) target of tax to GDP ratio of 25 percent thereby raising sufficient resources to support the Government's development agenda. Further, the policy intervention will also expedite the growth friendly fiscal consolidation plan designed to slow down the annual growth in public debt and implement an effective liability management strategy without compromising service delivery to citizens. This is expected to boost the country's debt sustainability position and ensure that Kenya's development agenda honours the principle of inter-generational equity.



**NJUGUNA S. NDUNG'U, C.B.S.**

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## PREFACE

Kenya tax policies have for a long time been expounded in the respective tax laws. The lack of a specific document on policies underpinning taxation creates challenges related to coherence in the application of tax policies in the country as well as reforms of the tax policies and related legislations. The Government has therefore developed this Policy to provide guidelines to the tax systems and administration reforms. The Policy has been guided by the international best practice in providing guiding principles to address the challenges identified in the tax system.

The Policy will be an important tool for enhancing revenue mobilization to facilitate implementation of the Government's Bottom-Up Economic Transformation Agenda (BETA) which is geared towards economic turnaround and inclusive growth. Realization of the BETA calls for enhanced revenues which can only be realized through well-coordinated reforms. Therefore, this Policy seeks to reform the tax policy landscape to enhance revenue mobilization by among other things, improving efficiency and effectiveness of the tax system.

Article 201 of the Constitution requires transparency and public participation in preparation of policies that affects the public. In this respect, the Policy was subjected to public participation to ensure that the policy guidelines spelt herein are demand driven and in sync with the evolving needs of taxpayers and all citizens. I wish to thank all stakeholders for the diverse comments and inputs that were submitted for consideration in the development of this Policy. We are committed to continue working with stakeholders in the implementation of this Policy so that together we can progressively improve the efficiency, transparency and accountability in the tax system.

In conclusion, I wish to thank all institutions and individuals who contributed to the development of this Policy. In particular, I wish to sincerely thank the technical team comprising of officers from the National Treasury and the Kenya Revenue Authority for dedicating their time and effort to ensure this document was finalised on time.



**DR. CHRIS KIPTOO, C.B.S.**

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## LIST OF ABBREVIATIONS

COMESA	Common Market for Eastern and Southern Africa
BETA	Bottom-up Economic Transformation Agenda
DTAs	Avoidance double taxation and fiscal evasion agreements
EAC	East African Community
EACCET	East African Community Common External Tariff
EACCMA	East Africa Community Customs Management Act, 2004
EPZ	Export Processing Zone
FY	Financial Year
GDP	Gross Domestic Product
IDF	Import Declaration Fee
KRA	Kenya Revenue Authority
MAC	Multilateral Convention on Mutual Administrative Assistance in Tax Matters
MDAs	Ministries, Departments and Agencies
MNEs	Multinational Enterprises
MTRS	Medium Term Revenue Strategy
PIN	Personal Identification Number
PFMA	Public Finance Management Act
RDL	Railway Development Levy
RML	Road Maintenance Levy
SEZ	Special Economic Zone
TAT	Tax Appeals Tribunal
VAT	Value Added Tax
WCO	World Customs Organization
WTO	World Trade Organization

## EXECUTIVE SUMMARY

The National Tax Policy (herein referred to as the Policy) sets out broad parameters on tax policy and other tax related matters. It articulates broad guidelines for governing tax administration and the tax system in Kenya. More specifically, it provides a set of policy guidelines for taxation of income, goods and services and forms the basis for review of tax legislation, development and administration. It is therefore a vital tool for revenue mobilization to facilitate implementation of the Government's priority programmes under the BETA.

The Policy is developed against a background of tight fiscal space occasioned by emerging expenditure pressures from drought and external shocks. At the same time, the tax system faces numerous challenges leading to underperformance in revenue collection. Kenya's revenue yield falls below the desired EAC's target of 25 percent of GDP required under the EAC Monetary Union convergence Criteria despite the heavy investments by the Government to transform the tax system. Ordinary revenue as a percentage of the GDP has generally been declining over the years from a high of 18.1 percent of the GDP in the FY 2013/14 to 15.1 percent of the GDP in the FY 2021/22. These challenges highlight the underlying policy issues affecting the tax system.

The key challenges identified in the tax system include: growing tax expenditure estimated at 2.61 percent of the GDP as of 2021; complexities in taxation of emerging economies such as online businesses, low tax compliance, challenges in international taxation, lack of guidelines for treaty negotiations and delay in settlement of tax dispute. The Policy provides specific recommendation to address each of the identified issues.

To address unpredictability of tax rates, the Policy recommends comprehensive review of tax laws every five years. On growing tax expenditure, the Policy recommends the development of framework for granting of tax incentives. To address challenges relating to international taxation and treaties, the Policy provides guiding principles on negotiation of bilateral, multilateral, regional and international tax agreements. In addition, the Policy provides policy guidelines meant to address key challenges affecting various tax heads.

Effective implementation of the Policy is crucial in ensuring realization of the desired results. Therefore, key implementers and stakeholders have been identified and their specific roles clearly defined. These include the National Treasury, the Kenya Revenue Authority, the National Assembly, the Judiciary, the State Law Office, County Governments and Ministry, Departments and Agencies (MDAs). A framework will be developed to monitor and evaluate the implementation of the Policy.

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 Introduction**

The main objective of taxation by governments is to raise revenue for the provision of public goods and services. Other non-revenue objectives include; income redistribution, regulation of consumption of goods and services with negative externalities, employment creation, price stability, and promotion of economic development through provision of targeted tax incentives which in turn promote investment and local value addition.

This Policy sets out broad guidelines on taxation and other tax related matters. It also articulates the principles governing tax administration in Kenya. Thus, it provides a set of guidelines for taxation of income and goods and services and forms the basis for review of tax legislation, development and administration. It is a vital tool for revenue mobilization that facilitates social and economic development. The Policy is guided by the principles of public finance as stipulated under Article 201 of the Constitution.

#### **1.2 Background**

Kenya's pre-independence tax system was characterized by a narrow tax base comprising of taxes such as hut tax, land tax and poll tax which were regressive in nature. After independence, the Government embarked on the modernization of the tax system through enactment of modern tax laws such as income tax, sales tax, excise duty and customs duty. In the 1960s and early 1970s, tax policies and laws were common across the East African Community (EAC), whose Partner States were Kenya, Uganda and Tanzania. After the collapse the EAC Community in 1977, each Partner State continued to use the same tax laws though the laws were modified with time to reflect the unique situations in the respective countries. Described below are the revenue Acts that guide domestic revenue mobilization.

##### ***1.2.1 Income Tax Act***

The income tax legislation was first enacted in the year 1921 as an Income Tax Ordinance which was repealed in 1933 by the Graduated Tax Ordinance. This too was later repealed by the Income Tax Ordinance of 1937. The 1937 Ordinance was also repealed and replaced with two laws on income i.e., the Income Tax Ordinance, 1940 and the War Taxation (Income Tax) Ordinance, 1940. These legislations were amended in 1941 through the War Taxation (Income Tax) (amendment) Ordinance, 1941.

In 1952, these Ordinances were repealed and the East African Income Tax (Management) Act, 1952 was enacted. In 1971, the income tax rates applicable were amended through the Income Tax (Rates and Allowances) Act, 1971. In 1973, both the East African Income Tax (Management) Act, 1952 and the Income Tax (Rates and Allowances) Act, 1971 were repealed and replaced with the Income Tax Act, 1973 which came into effect in 1st January 1974. The Act has been amended severally to align it with the changing operating environment and international best practice.

##### ***1.2.2 Sales Tax Act***

Kenya introduced sales tax in 1973 by enacting the Sales Tax Act due to the need to generate more revenue locally to finance the annual budget. The general rate of tax was 10 percent and was applicable on goods manufactured in Kenya by registered manufacturers or goods imported into Kenya. The manufacturers of the goods that were subject to the sales tax were required to be registered by the Commissioner in charge of revenue collection. In addition to the general rate of tax, some few goods were subject to specific rate of tax.

The tax base of the sales tax was narrow as it was only charged at the manufacturer's level or at the point of importation. The tax had a huge negative impact on local manufacturing since the manufacturers of the goods that were subject to the sales tax were not allowed to deduct the input tax, hence increasing the cost of goods.

### ***1.2.3 Transition from Sales Tax Act to Value Added Tax Act***

The Sales Tax Act 1973 was replaced by the Value Added Tax (VAT) Act in 1990. The transition from sales tax to VAT was informed by the fact that the former legislation was retrogressive and had negative impact on businesses because it did not provide for deduction of input tax. Unlike the sales tax, VAT allows supplies of taxable goods or services to deduct the tax paid on input supplies from the tax paid on output supplies and pay the excess to the Kenya Revenue Authority (KRA). If the excess is as a result of taxpayer supplying zero rated supplies, the taxpayer claims the (excess) refunds from the KRA and if the excess is not from zero rate supplies, the excess is carried forward to the next tax period. In addition, sales tax was being charged on goods only, whether locally manufactured or imported while VAT widened the scope by including services. When the VAT was enacted, the tax was considered a progressive tax and a major source of revenue to the Government. It was anticipated that the revenue collected from this tax would surpass revenues from other tax heads such as income tax, excise duty and import duty. However, as a proportion of the GDP, VAT has continued to yield less revenue than income tax.

The VAT Act (Cap. 476) underwent a major review in 2013 leading to a new structural design. The rationale for the review of the VAT Act was to modernize the legislation and, rationalize/reduce zero-rating and exemption of goods and services which had increased over time. The review was aimed at increasing the revenue raised from the VAT through minimizing tax expenditure as well as aligning it with international best practices. Through the enactment of the VAT Act, 2013, several goods and services were removed from the exemption and zero-rated Schedules. However, some of these supplies have been progressively re-introduced, thereby creating uncertainty in terms tax policy direction.

### ***1.2.4 Excise Duty Act and East African Community Customs Management Act, 2004***

Prior to Kenya joining the East African Community Customs Union in 2004, Customs and Excise Duties were administered under the Customs and Excise Act, Cap. 472. The East African Community Customs Management Act (EACCMA), 2004 was enacted by the East African Community Legislative Assembly to provide a legal framework to administer customs matters. However, excise matters continued to be administered under the Customs and Excise Act on transitional basis until 2015 when the Excise Duty Act, 2015 came into force.

The main objective of enacting the Excise Duty Act, 2015 was to have a separate legislation on excise duty matters from Customs since Customs matters were consolidated under the East African Community Customs Management Act, which was enacted in 2004. In addition, there was need to modernize the excise duty legislations.

## **1.3 Rationale of the Policy**

To achieve the country's development agenda, robust domestic resource mobilization is critical. In this regard, the development of this Policy is necessitated by the need to —

- (i) **Grow the tax revenue.** In an environment characterized by increased spending pressures and disproportionate growth in revenue as a ratio of GDP, there is need to undertake tax reforms within the confines of the Policy. The reforms will enhance domestic resource mobilization required to finance the Government's development

agenda, support a strong fiscal consolidation plan and steer the country towards achieving the Vision 2030;

- (ii) **Provide guidelines for development of a framework to grant tax incentives.** Over the years the Government has provided tax incentives to support government programmes and projects and also to promote investment by private sector in priority areas. In 2021, Kenya's tax expenditure was 2.61 percent of GDP which was comparable to the average of 2.9 percent for African countries. However, it is not clear what impact the tax incentives have had to the economy, hence the need to progressively monitor the effectiveness of the tax incentives. This Policy is critical in guiding the management and monitoring of the tax incentives to safeguard against erosion of the tax base and ensure they spur local production and contribute to economic growth;
- (iii) **Provide guidance, ensure certainty and establish consistency in future amendments to national tax laws.** Kenya's tax policies are contained in tax laws that are amended every year during the national budget process. Frequent changes to tax laws cause unpredictability in the tax system. This creates distortions, which impose additional costs to taxpayers and increase the cost of tax administration. This Policy will provide stability in the tax system to enhance certainty and consistency, which are key consideration by investors;
- (iv) **Enhance structures for information gathering and sharing.** Comprehensive information is important for tax collection, tax compliance and mitigation against tax avoidance and evasion. This Policy provides guidelines for enhancing information gathering and sharing to support revenue mobilization and protect the tax base;
- (v) **Efficiently manage tax refunds.** The tax refunds process is lengthy and constrained by inadequate information. The unpaid refunds withhold the working capital of the taxpayers thus imposing liquidity constraints on businesses. This Policy provides guidelines for enhancing timely processing of tax refunds;
- (vi) **Address complexities in tax legislation and administration.** There are complexities relating to tax administration and legislation which include computation of tax liabilities, filing of tax returns and interpretation of tax laws. These complexities affect the ease of doing business in the country. This Policy provides guidelines to address complexities in tax legislation and administration; and
- (vii) **To enhance public participation and accountability in the formulation of tax laws.** The Constitution lays out various national values and principles which are pertinent to the formulation of tax policy and laws. The Policy will specify the role of key institutions in tax policy formulation including their specific role in public participation during policy formulation and implementation.

#### **1.4 Objectives of the Policy**

The overall objective of this Policy is to guide the development of a progressive tax system and administration of Kenya's tax system in order to enhance revenue mobilization, promote investment and foster a flexible fiscal space. The specific objectives include—

- (i) To offer policy guidance on tax administration and enforcement of tax and custom laws;
- (ii) Promote investment and enhance regional and international trade;
- (iii) Enhance compliance with tax and customs legislations;

- (iv) Provide the basis for review and development of tax laws;
- (v) To guide stakeholders including investors on tax policy;
- (vi) Provide a basis for institutionalizing progressive tax culture;
- (vii) Provide principles for negotiation of bilateral, multilateral, regional and international agreements on tax and Customs matters
- (viii) Provide guiding principles for the Kenyan tax system;
- (ix) Provide guidelines for development of a framework for granting tax incentives and concessions to various sectors of the economy; and
- (x) Define the roles and responsibilities of key players in the tax administration.

### 1.5 Guiding Principles

This Policy is anchored principally on the national values and principles as espoused in Article 10 (2) of the Constitution of Kenya (2010) and includes the following principles —

- (i) **Economic efficiency:** the tax system shall minimize discrimination in favour of, or against, any economic choice to mitigate distortions and expand the productive capacity of the economy;
- (ii) **Equity and fairness:** the tax system shall be designed to treat equally all taxpayers placed in similar circumstances (horizontal equity), and treat differently those placed under different circumstances (vertical equity) ;
- (iii) **Simplicity:** tax laws and administrative processes shall be clear so that it is easy to comply and difficult to evade;
- (iv) **Administrative efficiency:** the cost of compliance by taxpayers and the administration cost to the Revenue Authority, shall be kept at a minimum level;
- (v) **Flexibility:** while the tax system shall provide certainty of “direction”, it will be dynamic and responsive to changing circumstances in the economy;
- (vi) **Revenue adequacy:** the tax system will be designed to mobilize adequate tax revenues to meet the needs of public expenditure;
- (vii) **Transparency and accountability:** the tax system shall enhance disclosure of information on revenues collected and tax expenditures;
- (viii) **Neutrality:** the tax system shall minimize discrimination in favour of, or against, any economic choice; and
- (ix) **Consultative:** The National Treasury and the KRA, will consult key players defined in this Policy in developing and implementing changes to the tax system to ensure it adheres to the guiding principles and meets the constitutional requirements.

## CHAPTER TWO SITUATIONAL ANALYSIS

### 2.1 Legal and Regulatory Framework

Taxation in Kenya is anchored in Article 209 of the Constitution which empowers the National Government to impose Income Tax, Value-Added Tax, Excise Duty, Customs Duties and other duties on imports and exports, as well as any other tax which may be provided for through an Act of Parliament. The Article also empowers County Governments to charge property rates, entertainment taxes and any other tax authorised by an Act of Parliament. Additionally, both the National and County Governments are allowed to impose charges for the services they offer.

Article 210 of the Constitution provides that taxes can only be imposed, waived or varied through an Act of Parliament. Further, the Article provides that the burden of taxation shall be shared fairly, and the revenue raised nationally shall be shared equitably among National and County Governments.

The Article sets out the principles of public finance under which tax laws, administrative processes and procedures are expected to be aligned to. In addition, the Public Finance Management Act (PFMA), 2012 prescribes the fiscal responsibility principles including a requirement for a reasonable degree of predictability with respect to the level of tax rates and tax base.

In addition to the Constitution and the Public Finance Management Act PFMA, 2012 (PFMA), there are tax laws administered by the National Government. These include —

- (i) *The Income Tax Act, (Cap. 470)*: Provides for ascertainment, assessment and collection of tax on income;
- (ii) *The Value Added Tax Act, 2013*: Provides for the imposition of value added tax on goods and services made in or imported into Kenya;
- (iii) *The Excise Duty Act, 2015*: Provides for the charge, assessment and collection of Excise Duty on excisable goods and services;
- (iv) *The Tax Procedures Act, 2015*: Provides for harmonization and consolidation of procedural rules for the administration of tax laws in Kenya;
- (v) *The East African Community Customs Management Act, 2004*: provides for the management and administration of customs related matters in the EAC region;
- (vi) *The Miscellaneous Fees and Levies Act, 2016*: Provides for the imposition of fees and levies on goods imported into the country for consumption in Kenya and export duties to encourage value addition on exports of locally produced goods;
- (vii) *Tax Appeals Tribunal Act, 2013*: Provides for establishment of a tribunal for the management and administration of tax appeals; and
- (viii) *Kenya Revenue Authority Act, (Cap. 469)*: Provides for establishment of the Kenya Revenue Authority which is a central body for assessment and collection of revenue, for the administration and enforcement of the laws relating to revenue and to provide for connected purposes.

### 2.2 Tax Administration

The role of tax administration includes management, direction and supervision of the implementation and application of tax laws and tax conventions to which Kenya is party to.

Tax administration includes assessment, collection, enforcement, litigation, publication and statistical gathering functions under the various tax laws or conventions.

### **2.2.1 Key Players in Tax Administration**

Key players in tax administration include the National Treasury, KRA, the National Assembly, the Judiciary, taxpayers, professional bodies, training institutions and tax advisors.

#### **(a) The National Treasury**

The National Treasury is responsible for formulation of tax policies and overseeing tax collection and accounting of the tax collected by KRA as well as control of tax expenditures. To achieve this mandate, the National Treasury proposes to the National Assembly policy changes to tax laws in form of Bills for enactment from time to time.

#### **(b) Kenya Revenue Authority**

KRA was established by the Kenya Revenue Authority Act, Cap. 469 of the laws of Kenya, which became effective on 1st July, 1995. The core functions of KRA are —

- (i) To assess, collect and account for all revenues in accordance with the written laws and the specified provisions of the written laws;
- (ii) To advise on matters relating to the administration of, and collection of revenue under the written laws or the specified provisions of the written laws;
- (iii) To administer revenue aspects of the Acts listed in the First and Second Schedules of the KRA Act (Cap 469) and collects levies for various Government Agencies under the provision of various Acts; and
- (iv) To perform such other functions in relation to revenue collection as the Cabinet Secretary responsible for matters relating to finance may direct.

Whereas KRA is the principal agency mandated to collect government revenue, County Governments and other national government agencies facilitate collection of fees and levies in their jurisdictions.

#### **(c) National Assembly**

The National Assembly enacts and oversees the administration of tax laws.

#### **(d) Judiciary**

The Judiciary facilitates settlement of tax disputes between KRA and the taxpayers. It creates jurisprudence on tax laws and lends clarity to legislative interpretation.

#### **(e) Taxpayers**

Taxpayers have an obligation to comply with tax laws including registration for tax obligations, filing accurate tax returns and timely payment of taxes due. Taxpayers also gives feedback on sections of tax legislations that require review.

#### **(f) Professional Bodies**

Professional bodies regulate the conduct of their members and facilitate their continuous professional development. They provide inputs in the formulation of tax laws and other subsidiary legislations. In addition, they facilitate engagements between tax administration and their members on tax matters.

### **(g) Training Institutions**

The training institutions build capacity of various stakeholders such as tax administrators, judicial officers, tax advisors and tax agents on tax matters.

### **(h) Tax Advisors**

Tax advisors provide guidance to their clients on compliance with tax laws and regulations. They also represent their clients before the Commissioner, Tax Appeals Tribunal and Courts, in tax dispute resolution.

## **2.2.3 Tax Administration Functions**

### **Registration of Taxable Persons**

**(i) Registering** and issuing unique Personal Identification Number (PIN) to taxpayers to facilitate enforcement of tax laws.

### **(ii) Promotion of Tax Compliance**

Facilitating taxpayer registration and education, filing of returns, payment of taxes, and assessing accuracy in reporting by the taxpayers. In the FY 2021/22, the filing and payment compliance stood at 70 percent and 77 percent respectively.

### **(iii) Capacity Building**

Recruit, continuously train and equip tax administration staff with modern technological tools to enable them effectively address emerging issues in tax administration.

### **(iv) Processing of Tax Refunds**

Verifying and processing of taxpayer's tax refund applications. Conduct staff and taxpayer awareness programs on the refund processing procedures including lodgement of the refund claim, assessment, approval and payment.

### **(v) Fostering Collaboration in Tax Collection**

Fostering effective and efficient collaboration with different Government agencies including National Government, County Governments and MDAs that facilitate collection of tax revenues, fees and levies at various levels.

### **(vi) Upgrading of Tax Collection System**

Upgrading the tax collection systems when necessary to ensure efficiency, fairness and ease of administrative of the tax regime.

### **(vii) Cost of Collection**

Progressively improve administrative and technological efficiency in collection of revenue so that the cost of tax revenue collection is kept at a minimum level.

### **(viii) Foster a Dispute Resolution Mechanism**

Handling tax disputes effectively, prudently and improving access to dispute resolution services to all taxpayers. Kenya has a graduated tax dispute resolution mechanism that is accessible to all taxpayers. The stages in this mechanism comprise of —

- (i) Tax decisions objections;
- (ii) Tax Appeals Tribunal (TAT);
- (iii) Appeals to the High Court;
- (iv) Appeals to the Court of Appeal; and
- (v) Appeals to the Supreme Court.

The Tax Procedures Act, 2015 and the Tax Appeal Tribunal Act, 2013 provide for settlement of tax disputes out of Court or out of Tax Appeals Tribunal. When an appeal is before the Tribunal or the Courts, the taxpayer or Commissioner may voluntarily request for the dispute to be handled through an out of Court or out of the Tax Appeals Tribunal settlement as an alternative method of handling tax disputes.

### **2.3 International Tax and Treaties**

Taxation of profits earned by Multinational Enterprises (MNEs) is complex as the entities operate in several tax jurisdictions around the world. Different tax jurisdictions impose different rules, but international standards have been developed to create consistency through bilateral or multilateral treaties. These treaties largely adopt international best principles and guidelines.

As at 2021, Kenya had entered into fifteen Agreements on Avoidance of Double Taxation and Prevention of Fiscal Evasion (DTA) with respect to taxes on income and capital gains with various countries. The agreements help to eliminate double taxation, allocate taxing rights between the treaty parties and reduce incidences of tax evasion through exchange of information. In addition, the country has ongoing DTA negotiations with various countries across the world.

Kenya is a member of the Global Forum on Transparency and Exchange of Information for tax purposes which works on the implementation of global transparency and exchange of information standards around the world. In addition, Kenya is party to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAC) which provides for all possible forms of administrative co-operation between states in the assessment and collection of taxes including exchange of information and the recovery of foreign tax claims. Kenya is also a member of the Organisation for Economic Corporation and Development (OECD) Inclusive Framework on Base Erosion & Profit Shifting (BEPS), a multilateral initiative focused on developing standards on prevention of base erosion and profit shifting related issues.

### **2.4 Tax Structure**

Taxes are categorized into direct and indirect taxes. Direct taxes are taxes on income of a person and the burden of the tax falls on the person who earns the income. On the other hand, indirect taxes are taxes on consumption of goods and services and the burden of the tax falls on the consumer. Customs duties are charges made on imported or exported goods. Direct taxes are currently the major sources of revenue to the Government followed by indirect taxes and customs duties.

#### **2.4.1 Direct Taxes**

##### ***Income Tax***

Income tax is an annual tax charged on income of a persons whether resident or non-resident, which is accrued in or is derived from Kenya. With few exceptions, Kenya operates a source-based tax system, implying that income is only subject to tax in Kenya if it was earned in Kenya irrespective of the residence of the income earner.

The Income Tax Act (Cap. 470), stipulates incomes to include: business income, dividends and interests, employment income, royalties, rental income, pension income, income from a digital marketplace; natural resource income, leases, capital gains or income deemed to be income of a person.

Income tax of person is classified into two major categories. These are:

### **i. Corporate Income Tax**

This income tax is levied on annual income of corporate bodies such as limited companies, trusts, and co-operatives. Companies registered outside Kenya but operating or having branches in Kenya are subject to tax on income accrued in Kenya. Such entities are referred to as permanent establishments. Corporate income tax is paid in instalments by the 20th of the 4th, 6th, 9th and 12th month of a company's financial year. Any balance of tax at the end of the year must be paid within four months of the financial year end. However, persons involved in agricultural activities pay their corporate income tax in two instalments in the proportion of 75% and 25% payable in the 9th and 12th month respectively of the company's financial year.

### **ii. Personal Income Tax**

Personal Income Tax (PIT) is levied on the wages, salaries, dividends, interest, and other income earned by a person in gainful employment. Tax on wages and salaries is charged through a graduated scale known as Pay As You Earn (PAYE). Companies, partnerships and individuals with liable employees are required to deduct tax in accordance with the prevailing tax rates from their employees' salaries or wages on each payday for a month and remit the same to KRA on or before the 9th of the following month. Self-employed individuals (partnerships and sole proprietorships) are required to account and pay taxes on the income derived or accrued in Kenya.

## **2.4.2 Indirect Taxes**

### **(a) Value Added Tax (VAT)**

VAT is a consumption tax charged under the Value Added Tax Act, 2013 on supply of goods and services. The supplies are categorised into zero-rated, exempt or standard rated supplies. The tax is charged on the value added at different stages of production and at different levels of the distribution chain of goods or services.

The VAT Act requires that a person who, in the course of business, makes taxable supplies or expects to make taxable supplies whose value is five (5) million shillings or more within a period of twelve (12) months or is about to commence making taxable supplies whose value is expected to exceed five (5) million shillings within a period of twelve (12) months, shall be liable for registration and apply to the Commissioner of Domestic taxes for registration.

Taxpayers are required to account for tax at the time of supply, file tax returns and make payment not later than the 20th day of the following month in which the supply occurred. However, for imported goods, tax is collected at the point of importation by the Commissioner of Customs and Border Control.

VAT in Kenya is based on the destination principle and therefore provides for zero rating of exported goods and taxable services. Generally, all goods and services are vatatable unless expressly provided for under the Act as exempt supplies.

### **(b) Excise Duty**

Excise duty is a consumption tax charged on excisable goods manufactured in Kenya by a licensed manufacturer, or excisable services supplied in Kenya, or on excisable goods imported into Kenya. Besides generating revenue, excise duties are also designed to address negative externalities associated with consumption of certain goods and services. However, exemption from excise duty applies to goods and services exported from Kenya or those specifically provided for in the Excise Duty Act, 2015.

Excise duty is mainly charged a specific rate or at ad valorem rates to a narrow or selected base of goods and services. The tax period for which the excise duty must be reported and paid is

the calendar month and the prescribed due date as provided for in the Excise Duty Act, 2015 which is on or before the 20th of the succeeding month on which the sales are made. However, for imported goods, excise duty is collected at the point of importation by the Commissioner of Customs Services.

### **2.4.3 Customs Duty**

Customs Duty is a tax levied on either the importation or exportation of goods across international borders. Kenya as a member of the East Africa Customs Union, administers the EAC Customs Management Act, 2004, EAC Common External Tariff (EACCET) and the EAC Rules of Origin.

For collection of custom duties, the rules of international trade by way of Treaties, Conventions and Instruments of World Trade Organisation (WTO) and World Customs Organisation (WCO) to which Kenya is a signatory are considered. Kenya being a member of the EAC and the Common Market for Eastern and Southern Africa (COMESA), accord any goods confirmed to be imported from member countries of either entity preferential rates of import duty.

Import duties are computed either as a percentage of the value of imports (ad valorem) or at a specific duty rate whichever is higher. The import duty rate structure is based on the general categorization of goods where raw materials and capital goods attract no duty, intermediate goods attract a higher rate of duty and finished goods attract the highest rate of duty to discourage importation of such goods. Some categories of goods that are classified as sensitive attract a higher rate of duty than other goods. These are mainly goods that are produced in the region hence the need to protect them against competition from imported goods.

To address shortage of foreign exchange, which was resulting from reduced exports, the Government in 1993, introduced an Export Processing Zones (EPZ), to promote exports. Under the EPZ, firms are provided with tax incentives to produce goods for export. The incentives include a ten-year corporate tax holiday and a reduced corporate tax rate of 25 percent thereafter for a further ten years. In addition, there is a ten-year withholding income tax holiday on dividend and other remittances to non-resident. Further, all goods imported into the EPZ, except motor vehicles are exempt from import duty, excise duty, VAT, fees and levies. The firms operating in the EPZ also enjoy favourable business regulatory procedures.

Other schemes that are being implemented by the government for promotion of exports include Manufacturing Under Bond (MUB) and Special Economic Zone (SEZ). Under MUB, raw materials imported are not subject to import duty, VAT, excise duty, fees and levies. Finally, under the SEZ, firms are provided with lower corporation tax rate, in addition to exemption of raw materials and inputs imported into the zone from VAT, import duty, excise duty, fees and levies. Goods produced under EPZ, SEZ or MUB when sold to the domestic market are subject to all taxes, fees and levies just like goods imported from a foreign territory.

### **2.4.4 Other Charges on Imported Goods**

Imported goods may also attract fees or levies such as Railway Development Levy (RDL) and Import Declaration Fee (IDF). IDF and RDL are charged on goods imported for home use excluding goods originating from EAC Partner States, or the goods imported by diplomats and institutions with privileges and immunities.

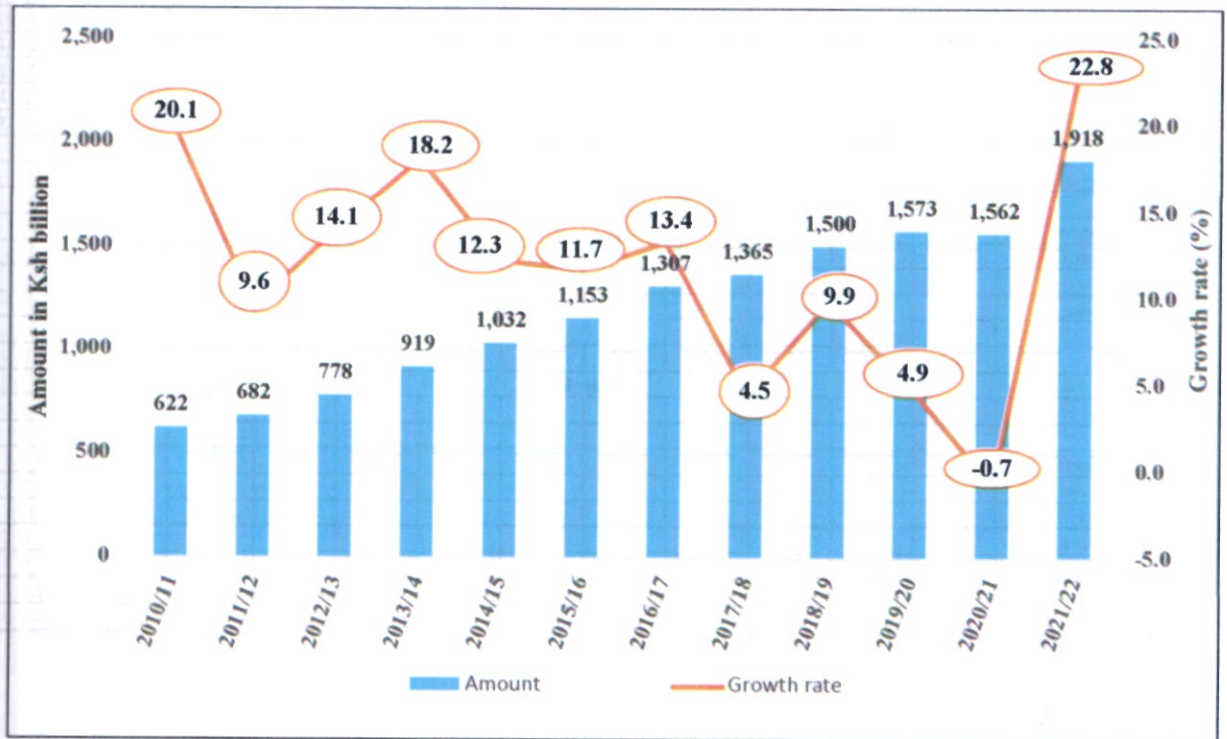
## **2.5 Revenue Performance**

### **(i) Ordinary Revenue Growth**

Ordinary revenue includes tax revenue plus non tax revenue. This is referred to as Exchequer Revenue. The Government has invested heavily in the transformation of the tax system

through modernization of tax laws and automation of the tax administration aimed at improving productivity of the tax regimes. This has led to a gradual rise in ordinary revenue, in absolute terms, from KSh. 622 billion in FY 2010/11 to KSh. 1.918 trillion in FY 2021/22. Despite the positive growth in absolute terms, the annual growth rate has been declining. The pickup in FY 2021/22 is attributed to the base effect after recovery from the adverse effects of COVID-19 pandemic. Upgrading the tax collection systems when necessary to ensure efficiency, fairness and administrative feasibility of the tax regime. (Figure 1).

**Figure 1: Ordinary Revenue Performance**



Source: The National Treasury

Income tax and Value Added Tax, constitute the largest share of revenues in Kenya. In FY 2021/22, as a percentage of ordinary revenue, income tax accounted for 45.7 percent while VAT accounted for 26.5 percent (Table 1).

**Table 1: Composition of Ordinary Revenue for the period 2010/11 to 2021/22**

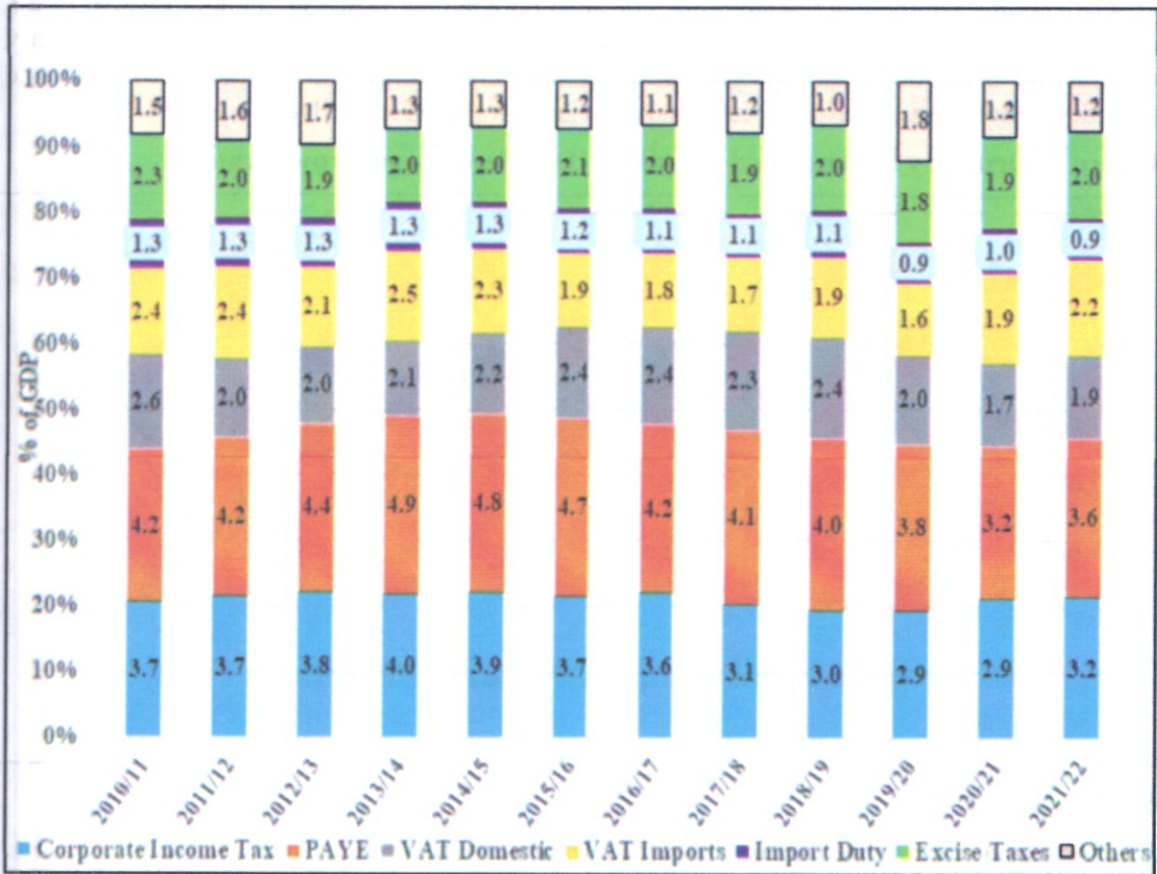
Actual Collections (Ksh millions)												
Tax Head	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Corporate Income Tax	128,079	146,427	173,039	199,717	228,785	247,406	287,389	277,241	291,890	307,735	330,709	414,350
PAYE	144,361	166,036	199,847	249,873	279,798	313,356	317,661	363,305	393,440	399,201	363,343	462,357
VAT Domestic	90,211	81,496	90,714	107,737	127,905	160,317	194,234	206,243	230,776	213,884	197,072	244,926
VAT Imports	81,670	94,891	94,202	124,893	131,781	128,897	144,800	150,886	183,368	169,829	213,687	278,173
Import Duty	46,072	51,712	57,650	67,555	74,048	79,638	89,943	93,665	106,875	98,022	108,375	118,280
Excise Taxes	90,567	78,884	85,660	102,029	115,872	140,212	165,474	167,753	194,310	195,270	216,325	252,094
Others	50,893	62,320	76,671	67,185	73,633	82,719	87,067	105,950	99,099	189,477	132,504	147,753
<b>Total</b>	<b>621,852</b>	<b>681,766</b>	<b>777,784</b>	<b>918,990</b>	<b>1,031,819</b>	<b>1,152,544</b>	<b>1,306,568</b>	<b>1,365,063</b>	<b>1,499,757</b>	<b>1,573,418</b>	<b>1,562,015</b>	<b>1,917,911</b>
<b>Nominal GDP</b>	<b>3,447,694</b>	<b>3,990,412</b>	<b>4,506,152</b>	<b>5,051,646</b>	<b>5,831,528</b>	<b>6,709,671</b>	<b>8,081,061</b>	<b>8,922,320</b>	<b>9,745,599</b>	<b>10,620,841</b>	<b>11,370,323</b>	<b>12,736,133</b>
As a Share of GDP (%)												
Corporate Income Tax	3.7	3.7	3.8	4.0	3.9	3.7	3.6	3.1	3.0	2.9	2.9	3.3
PAYE	4.2	4.2	4.4	4.9	4.8	4.7	4.2	4.1	4.0	3.8	3.2	3.6
VAT Domestic	2.6	2.0	2.0	2.1	2.2	2.4	2.4	2.3	2.4	2.0	1.7	1.9
VAT Imports	2.4	2.4	2.1	2.5	2.3	1.9	1.8	1.7	1.9	1.6	1.9	2.2
Import Duty	1.3	1.3	1.3	1.3	1.3	1.2	1.1	1.1	1.1	0.9	1.0	0.9
Excise Taxes	2.3	2.0	1.9	2.0	2.0	2.1	2.0	1.9	2.0	1.8	1.9	2.0
Others	1.5	1.6	1.7	1.3	1.3	1.2	1.1	1.2	1.0	1.8	1.2	1.2
<b>Total</b>	<b>18.0</b>	<b>17.1</b>	<b>17.3</b>	<b>18.2</b>	<b>17.7</b>	<b>17.2</b>	<b>16.2</b>	<b>15.3</b>	<b>15.4</b>	<b>14.8</b>	<b>13.7</b>	<b>15.1</b>
Growth (%)												
Corporate Income Tax	30.0	14.3	18.2	15.4	14.6	8.1	16.2	-3.5	5.3	5.4	7.5	25.3
PAYE	18.9	15.0	20.4	25.0	12.0	12.0	7.8	7.6	8.3	1.5	-9.0	27.3
VAT Domestic	14.4	-9.7	11.3	18.8	18.7	25.3	21.2	6.2	11.9	-7.3	-7.9	24.3
VAT Imports	29.4	16.2	-0.7	32.6	5.5	-2.2	12.3	4.2	21.5	-7.4	25.8	30.2
Import Duty	11.6	12.2	11.5	17.2	9.6	7.5	12.9	4.2	14.1	-8.3	10.6	9.1
Excise Taxes	8.7	-2.1	8.6	19.1	13.6	21.0	18.0	1.4	15.8	0.5	10.8	16.5
Others	25.8	22.5	23.0	-12.4	9.6	12.3	5.3	21.7	-6.5	91.2	-30.1	11.5
<b>Total</b>	<b>20.1</b>	<b>9.6</b>	<b>14.1</b>	<b>18.2</b>	<b>12.3</b>	<b>11.7</b>	<b>13.4</b>	<b>4.5</b>	<b>9.9</b>	<b>4.9</b>	<b>-0.7</b>	<b>22.8</b>
<b>GDP</b>	<b>14.3</b>	<b>15.7</b>	<b>12.9</b>	<b>12.1</b>	<b>15.4</b>	<b>15.1</b>	<b>20.4</b>	<b>10.4</b>	<b>9.2</b>	<b>9.0</b>	<b>7.1</b>	<b>12.6</b>

Source: The National Treasury

**(ii) Ordinary Revenue growth in relation to Nominal GDP**

Despite the heavy investments by the Government to transform the tax system, Kenya's revenue yield is still below the desired EAC target of 25 percent of GDP. Ordinary revenue as a percentage of GDP has generally been declining over the last ten years from a high of 18.2 percent in the FY 2013/14 to 15.1 percent in the FY 2021/22 (Figure 2).

**Figure 2: Total Ordinary Revenue Categories as a Share of GDP**



Source: The National Treasury

The declining trend in ordinary revenue to GDP ratio is attributable to a decline in revenue performance of specific tax heads with income tax declining from 7.9 percent of GDP in FY 2010/11 to 6.9 percent in FY 2021/22; Value Added Tax from 5.0 percent to 4.1 percent and Excise Duty from 2.3 percent to 2.0 percent of GDP over the same period. On the other hand, Import Duty averaged at around 1.2 percent of GDP over the 10-year period (Figure 2).

**(iii) Ordinary Revenue-to-GDP Ratio for Selected Countries**

The average total tax revenue as a percentage of GDP over the period FY 2010/11 to FY 2020/21 for Kenya was 16.4 percent (Table 2). Although this is higher than that of the other East African countries (Rwanda, Tanzania, Uganda and Burundi), which stands at 13.7 percent, it is still below the desired EAC target of 25 percent. South Africa, on average, performed better than Kenya over the same period at 25.8 percent of GDP.

**Table 2: Ordinary Revenue-to-GDP Ratio for Selected Countries**

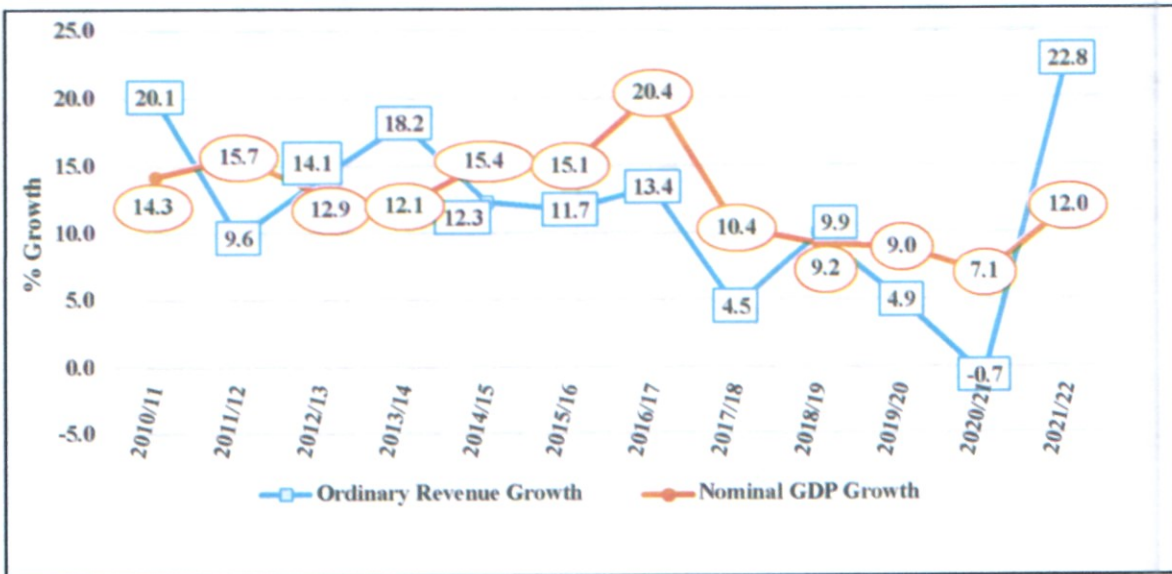
Country	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	Average
Kenya	18.0	17.1	17.3	18.2	17.7	17.2	16.2	15.3	15.4	14.8	13.7	16.4
Rwanda	13.6	13.9	14.5	14.9	15.1	16.1	15.2	15.6	16.3	15.9	16.6	15.2
Tanzania	11.1	11.4	11.8	12.6	11.7	13.3	13.2	13.4	11.4	12.2	11.4	12.1
Uganda	13.2	12.7	11.1	11.3	12.3	12.8	14.1	14.2	15.4	12.1	13	12.9
Burundi	14.1	16.3	15.1	13.6	13.7	13	13.4	13.6	14.1	15.8	16.5	14.5
South Africa	24.6	25	25.3	26.1	25.7	26.2	26	25.8	26.2	26.4	26	25.8

Source: EAC Comparative Revenue Data

**(iv) Tax Buoyancy**

Over the years, Kenya’s tax system has not been buoyant. In principle, annual growth in tax revenue should be more than the growth in nominal GDP. In some years, the growth in ordinary revenue has been lower than the growth in nominal GDP (**Figure 3**), implying that revenue growth has not been consistently responsive to growth in nominal GDP.

**Figure 3: Ordinary Revenue and Nominal GDP (Percentage Growth rate)**

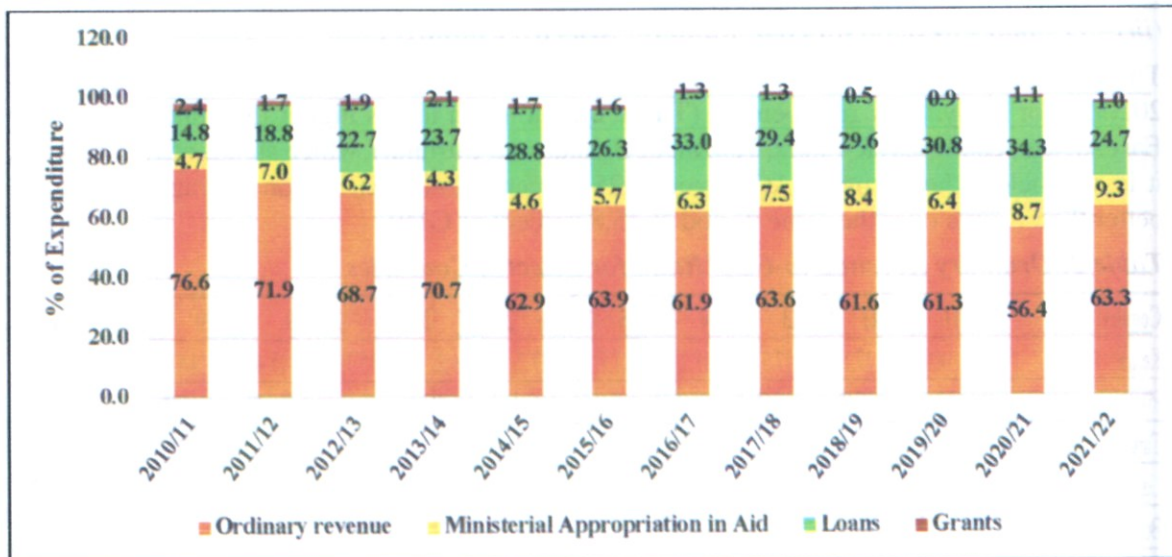


Source: The National Treasury

**(v) Source of Financing for Government Expenditure (percent)**

The ratio of ordinary revenue to total Government expenditure declined from 76.6 percent in FY 2010/11 to 63.3 percent in FY 2021/22 (**Figure 4**). Over the same period, the ratio of ordinary revenue to total Government expenditure averaged 65.2 percent. This implies that on average 34.8 percent of the total Government expenditure was financed through loans, grants and ministerial Appropriations-in-Aid for the period under review.

**Figure 4: Source of Government Expenditure Financing**



Source: The National Treasury

## CHAPTER THREE

### CHALLENGES FACING KENYA'S TAX SYSTEM

Significant progress has been made in transforming the country's tax system. However, the system still faces challenges which have had a negative impact on revenue performance. These challenges include:

#### *3.1 General Challenges*

##### *i. Existence of hard to tax sectors*

The economy is dominated by a large informal sector, which is difficult hard to tax. The sector is characterized by poor record keeping, cash-based transactions and limited information due to its unregulated nature. For instance, the actual contribution to tax revenue of the agricultural sector, which forms a major part of this category, is not commensurate to the sector's contribution to GDP which averages 21.4 percent. Previous efforts to tax this sector including the use of turnover tax and presumptive income tax have not realised the expected tax revenues.

##### *ii. Tax incentives*

The tax laws provide various tax incentives in the form of tax exemptions, tax relief, allowances, tax deferral and concessional tax rates or timing rules such as accelerated depreciation of capital investments. Although, the incentives are aimed at promoting investments and providing relief to low-income earners and vulnerable groups in the society, they erode the tax base and cause the Government to forego tax revenue. This therefore has a negative impact on revenue mobilisation and implementation of the government programmes.

##### *iii. Low tax compliance*

Tax compliance in terms of filing tax returns and payment of tax due, stood at 70 percent in the FY 2020/21 and 77 percent in the FY 2021/22. The levels of compliance is mainly hindered by the technical and complex nature of tax laws and procedures, taxpayer apathy, high compliance cost, inadequate sharing of taxpayer information among National and County Government agencies, lack of physical presence of KRA offices in some regions of Kenya and low tax literacy among citizens. These factors make it difficult for taxpayers to file returns and pay taxes due.

##### *iv. Complexity in taxing emerging digital economy*

The tax system is not fully equipped to deal with emerging technological business models. This has led to some business activities being left out of the tax net especially activities carried out through the internet on digital platforms. These business activities can be carried out in a tax jurisdiction without having any physical presence in that jurisdiction.

#### *3.2 Challenges to specific tax head*

##### *i. Income Tax*

The taxation of income earned or derived in Kenya is faced with challenges which include —

- (a) Lack of clarity on taxation of some income derived or earned in Kenya;
- (b) Lack of progressivity in taxation of the personal income. The tax bands are narrow and an individual reaches the top bracket at very low income;
- (c) Lack of guidelines for granting preferential tax rates;
- (d) Challenges in administering income tax exemption since other Acts of Parliament provides tax exemption;

- (e) Avoidance of tax by non-resident companies through repatriation of profits and also to avoid the high corporation rate for non-residence;
- (f) Lack of clarity on tax point on taxation of gains from sale of property leading to noncompliance;
- (g) Complexity in taxation of some sectors;
- (h) Deduction of expenditures which are not used for the production of income thus eroding the tax base;
- (i) Lack of principles to guide investment allowance leading to some deduction exceeding 100%; and
- (j) Multiple personal reliefs which erode tax base.

**ii. Value Added Tax**

The challenges facing VAT include —

- (a) High tax expenditure – VAT tax expenditure is relatively high compared to the overall VAT collection;
- (b) Multiple rates – In the year 2023, VAT Act provide for the following rates: 8 percent for petroleum products, 16 percent for other goods/services and 0 percent for exported goods. The lower rate on petroleum goods creates a perverse incentive for relatively higher consumption;
- (c) Violation of the destination principle of some goods and services in the Second Schedule;
- (d) Lack of guiding principles for identifying goods or services that will be, taxable, exempt or zero rated;
- (e) Low tax compliance; and
- (f) Regressivity in case where exemption provides higher VAT benefit to the richer section in comparison to the poor and vulnerable.

**iii. Excise Duty**

The challenges facing excise duty regime in Kenya include:

- (a) High excise duty rate of goods and services compared with the other EAC Partner States. This contributes to the increase in illicit trade across borders such as smuggling. High excise duty rates also discourage investment in the sector and distort the market;
- (b) Narrow tax bases as only few goods and services are subject to excise duty;
- (c) Lack of principles in identifying goods and services subject to excise duty; and.
- (d) Low Compliance due existence of illicit trade and, counterfeits excisable goods. This reduces revenues accruing from excise duty to the Government and creates unfair burden on compliant manufacturers and importers of excisable goods.

**iv. Customs Administration**

Dynamics in international trade including, emerging business models, new trading partners, increased security threats, organized crimes and increasing number of regional free trade areas that Kenya is a member of, present challenges in customs administration. Specifically, customs administration faces the following main challenges;

- (a) Low levels of automation in some custom processes creating loopholes for revenue leakage.
- (b) Inadequate —
  - (i) Modern technological tools at entry/exit border points to detect and deter cross border smuggling, mis-declaration, undervaluation and misclassification of goods;
  - (ii) Cargo monitoring and management;
  - (iii) Staff capacity and training to handle the ever-changing business environment;
  - (iv) Knowledge by importers and their agents on custom processes;
  - (v) Cooperation, coordination and collaboration amongst Government agencies on customs and border management matters; and
  - (vi) Customs-to-Customs regional and international cooperation to curb cases of abuse of rules of origin, cargo diversion and undervaluation.
- (c) Porous borders which create room for illicit trade.

### **3.3 International Taxation and Tax Treaties**

There is significant presence of Multinational National Enterprises (MNEs) that derive income from Kenya and constitute a significant source of revenue for the Government, including Kenyan companies that are fast expanding into other African markets. Most of the treaties that have been negotiated do not have provisions to address base erosion and profit shifting leading to exploitation of these gaps by some businesses to avoid paying taxes lawfully due in Kenya. Specifically, Kenya is faced with the following tax treaties and international taxation challenges —

- (a) Lack of policy guidelines for negotiation of bilateral, multilateral, regional and international tax agreements with regards to avoidance of double taxation, Customs tariffs and fiscal evasion;
- (b) Some DTAs in force were concluded many years ago hence not in line with the recent international best practice;
- (c) Abuse of tax treaties;
- (d) Inadequate mechanism to address base erosion and profit shifting by MNEs;
- (e) Insufficient technical capacity on international taxation; and
- (f) Emerging and evolving business models that cannot be adequately addressed by existing taxation frameworks.

### **3.4 Tax Administration**

KRA collects and account for tax revenue on behalf of the National Government. In carrying out this mandate, the Authority faces the following challenges —

- (a) High number of unregistered taxpayers;
- (b) Low taxpayer morale;
- (c) Limited access to taxpayer transactional information;
- (d) Inadequate capacity due to skills gap in handling emerging challenges; and

- (e) Limited collaboration and information sharing between the National and County Governments on tax matters;

### **3.5 *Tax Dispute Resolution***

Tax dispute resolution process in Kenya is, in most cases is adversarial occasioning a high number of disputes at the Tax Appeals Tribunal and in the Courts. Such disputes lock revenue over long periods of time.

### **3.6 *Unpredictable Tax Rates and Tax Bases***

The growth of government expenditure without corresponding growth of tax revenue has necessitated regular review of tax laws to expand the tax base. However, expansion of the tax base is limited by the structure of the economy which is dominated by informal sector and other structural factors. Frequent changes in tax rates and review of tax laws create unpredictability in the government policy.

## **CHAPTER FOUR POLICY GUIDELINES**

This chapter provides policy guidelines to address the challenges identified in chapter three as follows:

### **4.1 *Hard to tax sectors***

This policy aims at progressively increasing tax yields from agriculture and the informal sectors. To achieve this objective, the Government will —

- (i) Explore ways of enhancing the taxation of property transfers including land and agricultural sector;
- (ii) Explore ways of enhancing taxation of informal sectors including through increasing KRA's presence in big town and cities;
- (iii) Exploring mechanism for collecting taxes from the informal sector such as appointment of tax collection agents;
- (iv) Roll out education programmes to farmers and informal sector groups on taxation;
- (v) Require farmers and informal sector players to register with respective sub-sector associations and co-operative societies; and
- (vi) Enhance collaborations and exchange of information on taxpayers between the National Government and County Governments.

### **4.2 *Management of Tax Expenditure***

This policy aims at enhancing the management of the tax expenditure framework and ensuring analysis of the benefits is done before any tax expenditure is approved for implementation while rationalizing the existing tax expenditures. In principle, tax incentives and exemptions are economically inefficient, inequitable, adds to the complexity of the tax system and reduces revenue yield. In order to address this situation, the Government will —

- (i) Review the current tax expenditure and formulate a framework for granting tax incentive;
- (ii) Develop and regularly review guidelines for granting tax incentives taking into consideration the costs and benefits of the incentives.
- (iii) Maintain a record of all tax expenditures;
- (iv) Comprehensively review tax incentives after every five years to align them with the Government's agenda;
- (v) Require sector players that enjoy tax incentives to provide statistical data on the impact of the incentives to the growth of their businesses;
- (vi) Provide sunset provision for specific tax incentives granted to specific sectors where applicable;
- (vii) Develop and implement a centralized monitoring and evaluation framework for tax incentives; and
- (viii) Prepare tax expenditure reports annually.

### **4.3 *Increase in tax compliance level***

In order to progressively increase tax compliance levels and, revenue collection and reduce tax disputes between the revenue administrator and the taxpayers, the Government will —

- (i) Continuously review the mechanisms for detecting, deterring and sanctioning incidences of integrity in tax administration;
- (ii) Continuously leverage on the use of modern information technology in tax administration services and maintain up to date taxpayer records;
- (iii) Integrate tax and customs administration systems with relevant government agencies and other third-party systems;
- (iv) Regularly issue guidelines to the public to clarify any issues that may arise in the administration of tax laws;
- (v) Regularly review tax administration procedures to address gaps and emerging issues;
- (vi) Enhance implementation and monitoring of a structured and tailor-made engagement program for stakeholders;
- (vii) Strengthen the mechanism of educating different segment of taxpayers on changes to the tax laws and procedures;
- (viii) Enhance taxation awareness in the Kenyan education system;
- (ix) Penalize non-compliance and recognize compliant taxpayers;
- (x) Enhance the visibility and presence of the tax administration across the country including through enhanced surveillance and establishment of satellite offices;
- (xi) Enhance risk-based verification programs for detecting and deterring non-compliance; and
- (xii) Enhance public awareness on revenue collection and utilization for improved service delivery.

#### **4.4 Taxation of Emerging Digital Economy**

To progressively increase tax yields from emerging digital economy, the Government will —

- (i) Leverage on technology to detect with detection and enhanced compliance of emerging business transactions on digital or electronic platforms;
- (ii) Regularly review the tax regime that apply to digital marketplace to ensure optimal tax collection while ensuring compliance with the international consensus on taxation of the digital economy.
- (iii) Invest in continuous training of tax administrators and other key stakeholders on emerging technologies;
- (iv) Continuously review tax laws to align them with emerging technologies; and
- (v) Collaborate with relevant stakeholders to enhance taxation of the digital economy.

#### **4.5 Personal Income Tax**

Personal Income tax shall be guided by the following guidelines —

- (i) All income derived from or accrued in Kenya shall be subject to tax unless exempted under international agreements to which Kenya is party;
- (ii) The aggregate income shall be taxed in accordance with a progressive rate structure;

- (iii) The PAYE tax bands will be reviewed and designed to provide for progressive taxation, and a tax-free threshold or personal relief;
- (iv) Savings for retirements will be subject to exempt-exempt-taxed (EET) method of taxation where (i) contributions for retirements (pension) are deductible subject to a cap for improving progressivity, (ii) investment income of the contributed funds are exempt from taxation, and (iii) withdrawal/annuities are fully aggregated with the comprehensive income for taxation at the progressive rate structure;
- (v) All investment pooling vehicles shall be treated as "pass-thru" subject to prescribed regulations;
- (vi) Review all income tax reliefs such as personal, mortgage, and insurance reliefs every five years; and
- (vii) Review all financial limits and the tax bands every five years for inflation adjustment to minimize bracket-creep;

#### **4.6 Corporate Income Tax**

Corporate Income Tax shall be guided by the following —

- (i) The tax base for corporate income tax shall include all revenues sourced in Kenya on an accrual basis regardless of whether derived from business or any other activity;
- (ii) In the computation of taxable income from a business, deduction shall be allowed in respect to any expenditure incurred wholly and exclusively for the purposes of generating that income;
- (iii) The capital deductions allowable shall not exceed 100 percent of the actual cost of the investment or the asset;
- (iv) There shall be a single corporate tax rate; No preferential tax rate shall be granted. However, where a preferential rate is granted for specific government policy objectives, the tax rate shall not be lower than 50% of the general rate of corporation tax;
- (v) Exemption, if any, from income tax shall be provided in the Income Tax Act only;
- (vi) Repatriated profits for non-residents operating in Kenya through permanent establishment shall be subjected to tax at a rate equivalent to that charged to dividends paid to non-residents;
- (vii) There shall be a simplified method of taxation of income in cases of inherent difficulty in collection and tax administration on some sectors;
- (viii) There shall be a withholding tax on payment for some services and some income such as dividends, royalties, and interest payment;
- (ix) The investment allowance shall be spread over the period specified under the Income Tax Act; and
- (x) The method of calculating the investment allowance shall be the straight-line method.

#### **4.7 Value Added Tax**

VAT shall be guided by the following guidelines —

- (i) The tax base for VAT shall be domestic consumption of all goods and taxable services;
- (ii) Exemption, if any, from VAT will only be on consideration of costs compliance and administration costs;
- (iii) VAT shall be charged at all stages of production and distribution, including the retail stage;
- (iv) There shall be a single general rate of VAT;
- (v) No exemption or lower-than-standard rates shall be provided under VAT on distributional consideration;
- (vi) VAT shall be destination-based: that is VAT shall be charged on all goods and taxable services in the country of destination or consumption, not the country of origin or production;
- (vii) All exports whether goods or taxable services shall be zero-rated;
- (viii) All imports whether goods or services shall be charged VAT at par with domestically produced goods and taxable services;
- (ix) The criterion for determining whether a business firm or other entity is liable to VAT will be VAT registration threshold which will be determined on the basis of the cost vis-a-viz the benefit of collecting VAT from small firms or entities.
- (x) The VAT threshold shall be reviewed from time to time to align it with the prevailing economic situation;
- (xi) Voluntary registration for VAT may be allowed even where a person has not met the prescribed threshold; and
- (xii) Non-resident suppliers of digital services shall be registered for VAT irrespective of the threshold.

#### **4.8 Excise Duty**

Excise Duty shall be guided by the following guidelines —

- (i) The imposition of excise duty shall be based on the destination principle;
- (ii) Excise duty shall be charged on goods and services with negative externalities to discourage consumption due to their harmful nature and negative impact to the health of the consumer, environment, and the social evils that are caused by excess consumption and use of such goods and services;
- (iii) Despite the general principal of charging excise duty, specified under paragraph 4.7(ii) above, excise duty shall be charged on luxury goods, communication services and other goods as may be determined by the Government from time to time.;
- (iv) The specific goods and services subject to excise duty shall be as provided for in the Excise Duty Act;
- (v) The rate of excise duty shall be either ad valorem, specific or both;
- (vi) In determining whether to impose specific or ad valorem rate of excise duty, consideration shall be made to ensure no undue advantage is conferred to any category of goods;

- (vii) Excise duty paid on raw materials used in the manufacture of excisable products shall be offset against the excise duty payable on the finished goods;
- (viii) Excise duty shall not apply to the goods or services supplied to persons with privileges and immunities in accordance with international agreements and conventions, where Kenya is a party;
- (ix) Studies will regularly be undertaken on tax structure of excisable goods and services to determine the optimal rate of tax on each category of goods;
- (x) All excise duty exemptions shall be as provided for in the Excise Duty Act;
- (xi) Manufacturing, or supply of excisable goods and services shall be undertaken by a licensed/registered person;
- (xii) The Government shall continue participating in the EAC initiatives on harmonization of excise duty regime in the region; and
- (xiii) The Government shall put in place a system to facilitate enforcement of compliance with the Excise Duty Act.

#### **4.9 Customs administration**

To enhance customs administration, the Government will —

- (i) Ensure use of modern technology and enhance automation of customs procedures and processes;
- (ii) Continuously review the adequacy of the border posts/entry points for effective border management;
- (iii) Continuously build capacity of staff on customs matters;
- (iv) Enhance stakeholder education and awareness on custom processes;
- (v) Enhance cooperation between custom administration and MDAs;
- (vi) Cooperate with neighboring countries for establishment of more one-stop border posts;
- (vii) Enhance customs-to-customs cooperation to ensure exchange of information.
- (viii) Enhance monitoring of transit cargo, transfers and exports to curb transit or transfer of cargo diversions;
- (ix) Adopt strategies to continually address emerging trade patterns/trends such as cargo consolidation and trade agreements; and
- (x) Enhance measures to detect and deter illicit trade.

#### **4.10 Tax administration**

The following policy guidelines shall apply to Tax Administration —

- (i) The tax administration shall enhance access to mechanisms of registration and the registration of all potential taxpayers;
- (ii) The tax administration shall leverage on technology to facilitate registration and categorization of registered persons as per obligation and segmentation of sectors for ease of administration;

- (iii) There shall be continuous capacity development in revenue administration through training of staff, acquisition of equipment and technology to deal with emerging tax issues;
- (iv) Review guidelines on tax offset or refund processes with a view to making the process effective and efficient;
- (v) Enhance automation of tax refund process through integration of tax and customs administration systems;
- (vi) Progressively adopt a unified system for collection of taxes, fees and levies for the National and County Governments;
- (vii) Enhance collaboration in revenue mobilization and information sharing between the National Government, County Governments and MDAs; and
- (viii) Tax administration continuously enhance the system to facilitate registration or deregistration of taxpayers.
- (ix) Automate process of tax exemption to enhance efficiency, transparency and accountability in exemption processing.

#### **4.11 Tax Dispute Resolution**

To address the challenges with tax dispute resolution, the Government will —

- (i) Review the tax dispute resolution processes to reduce the cost and time for disputes resolution;
- (ii) Establish a technical committee to deal with public and private rulings on a regular basis;
- (iii) Provide for autonomy of the out of court or out of Tax Appeals Tribunal process of tax dispute resolution;
- (iv) Establish a high court that will specialize on tax matters; and
- (v) Enhance capacity for the Judiciary to deal with tax matters.

#### **4.12 International Taxation and Tax Treaties**

To progressively address tax malpractices, provide clarity, predictability and coherence to international tax laws relating to cross border transactions, the Government will —

- (i) Develop rules in line with international best practice to address base erosion and profit shifting risks;
- (ii) Enhance capacity of tax administration in dealing with cross border transactions and transfer pricing;
- (iii) Coordinate with other tax jurisdictions to address issues on taxation of cross border transactions; and
- (iv) Negotiate bilateral, multilateral, regional and international tax agreements with regards to avoidance of double taxation, Customs tariffs and fiscal evasion guided by the following principles —
  - (a) Analysis of the benefits vis-a-vis costs to achieve beneficial outcome to Kenya;
  - (b) Existence of significant trade between the two countries;
  - (c) The prevention of tax evasion and discrimination;
  - (d) Certainty and simplicity in addressing cross border activities;

- (e) Partnerships in conducting joint tax audits with other jurisdictions where such agreements are in place;
- (f) The impact of domestic legislation in the implementation of treaties (Limitation of Benefit Clauses);
- (g) Opportunities for mutual and technical assistance in capacity building;
- (h) Exchange of information and the collection of taxes; and
- (v) Periodically review avoidance of double taxation and fiscal evasion agreements to align with international best practice;
- (vi) Engage in bilateral and multilateral initiatives in building an international consensus on new and innovative international taxation tools;
- (vii) Develop a legal framework and infrastructure to facilitate automatic exchange of information and country-by-country reporting; and
- (viii) Domesticating international best practice arrangements to deal with base erosion and profit shifting.

#### **4.13 Predictability in tax rates and tax bases**

The Policy aims at providing a framework to guide, to a reasonable degree, predictable and sustainable rates of tax as well as widening of the tax base. To achieve these objectives, the Government will undertake —

- (i) Comprehensive review of tax laws every five years to align with other Government policies;
- (ii) Stakeholder engagement during review of tax laws and assessment of the impact of the proposed changes on tax revenue and investment;
- (iii) Periodic review of the tax laws to keep abreast with emerging trends in the business environment and the Government's agenda; and

A review to address emergencies, pandemics or natural disasters at any time such cases occur. The existing tax legislation and administration will be reformed to align with this Policy in a phased manner. For this purpose, Government will develop a four-year Medium Term Revenue Strategy (MTRS) that will contain specific reform measures necessary to move towards a modern tax system which will significantly enhance revenue mobilization. The Strategy will improve the predictability of tax rates thus facilitating investment decisions.

**CHAPTER FIVE**  
**IMPLEMENTATION FRAMEWORK**

This Chapter outlines the implementation framework as well as the roles and responsibilities of various actors in implementation of this Policy. The Government will ensure effective coordination of key players and stakeholders for the attainment of the policy objectives.

Different aspects of the Policy will be implemented by various actors including National and County Governments, Departments and Agencies. The table below specifies the key institutions identified in various sectors and their specific roles.

<b>Institution</b>	<b>Roles and Responsibilities in implementation of the Policy</b>
The National Treasury	<ul style="list-style-type: none"> <li>• Take lead in;               <ul style="list-style-type: none"> <li>(a) Implementation of the Policy.</li> <li>(b) Streamlining existing and future tax laws for coordinated implementation.</li> <li>(c) The comprehensive review of the Policy</li> <li>(d) Sensitization of stakeholders on the Policy</li> </ul> </li> <li>• Monitor the implementation of the Policy</li> <li>• Liaise with the Judiciary for the establishment of a tax court as an independent body to adjudicate tax matters.</li> <li>• Administer and monitor tax expenditures programme; and</li> <li>• Take lead in public participation on tax proposals.</li> </ul>
The Kenya Revenue Authority	<ul style="list-style-type: none"> <li>• Administration of tax laws in line with the Policy.</li> <li>• Conduct taxpayer's education and awareness on tax matters.</li> <li>• Provide feedback on the implementation of the Policy</li> <li>• Establish a system for prevention, detection, and deterrence of tax malpractices.</li> <li>• Liaise with bilateral and multilateral institutions on tax matters.</li> <li>• Advising the National Treasury on matters relating to the implementation of the Policy</li> <li>• Ensure requisite capacity for effective tax administration in line with the Policy; and</li> <li>• Sensitization of stakeholders on the Policy.</li> </ul>
County Governments	<ul style="list-style-type: none"> <li>• Comply with the Policy and tax laws;</li> <li>• Collaboration with National Government in the implementation of the Policy;</li> </ul>

	<ul style="list-style-type: none"> <li>• Facilitate integration of county revenue administration systems with the tax administration systems of the Kenya Revenue Authority; and</li> <li>• Provide relevant information to the tax administration to facilitate tax compliance.</li> </ul>
Ministries, Departments and Agencies	<ul style="list-style-type: none"> <li>• Comply with the Policy and tax laws;</li> <li>• Collaboration with tax and customs administration in the implementation of the Policy;</li> <li>• Collaboration with the National Treasury on review of tax laws in the implementation of the Policy;</li> <li>• In collaboration with tax and customs administration, build capacity of staff on tax matters in line with the Policy;</li> <li>• Support entrenching a tax paying culture in persons through the education and training systems; and</li> <li>• Collaborate with tax and customs administration through systems integration and information sharing for tax base expansion.</li> </ul>
Legislature	<ul style="list-style-type: none"> <li>• Support public participation on Bills for the implementation of the Policy;</li> <li>• Enhancement of a tax paying culture during stakeholder engagements;</li> <li>• Enactment of tax laws to support the implementation of the Policy; and.</li> <li>• Vetting and approval of subsidiary legislations to support the implementation of the Policy.</li> </ul>
Judiciary	<ul style="list-style-type: none"> <li>• Resolution of tax disputes between tax administrators and taxpayers;</li> <li>• Interpretation of tax laws;</li> <li>• Establishment of a tax court;</li> <li>• Facilitate out of court tax dispute resolution through the mediation process.; and</li> <li>• Facilitate capacity building of judicial officers on tax matters.</li> </ul>
State Law Office	<ul style="list-style-type: none"> <li>• Provide legal advice on tax matters;</li> <li>• Legislative drafting of tax laws to facilitate the implementation of the Policy; and.</li> <li>• Facilitate approval of the Policy by the Cabinet.</li> </ul>
The National Police Service	<ul style="list-style-type: none"> <li>• Investigate non-compliance with the tax laws;</li> <li>• Recommend tax law offenders for prosecution; and</li> </ul>

	<ul style="list-style-type: none"> <li>• Apprehend tax law offenders to enforce the rule of law;</li> </ul>
Office of the Director of Public Prosecution	<ul style="list-style-type: none"> <li>• Prosecute tax law offenders;</li> <li>• Collaborate with the tax and customs administration on prosecution of tax law offenders; and</li> <li>• Appointment of prosecutors on tax laws offenders.</li> </ul>
Professional Bodies and Practitioners	<ul style="list-style-type: none"> <li>• Comply with the Policy and tax laws;</li> <li>• Provide tax advice to taxpayers to facilitate compliance;</li> <li>• Act in accordance with professional code of conduct and ethics;</li> <li>• Sensitize their members and clients on the Policy and legislative changes;</li> <li>• Provide inputs in the review of the Policy and tax legislations; and.</li> <li>• Facilitate training and capacity building of relevant stakeholders on tax matters.</li> </ul>
Media	<ul style="list-style-type: none"> <li>• Support tax education and awareness in accordance with their professional code of conduct and ethics; and</li> <li>• Support entrenching a tax culture in society.</li> </ul>
Private Sector Associations and Non-State Actors	<ul style="list-style-type: none"> <li>• Organize and mobilize community stakeholders for public participation on tax matters;</li> <li>• Provide proposals and input on the tax laws in line with the Policy; and</li> <li>• Collaborate with the tax and customs administration in tax education and awareness of their members.</li> </ul>
Taxpayers	<ul style="list-style-type: none"> <li>• Comply with the Policy and tax laws;</li> <li>• Provide feedback on tax administration services on the implementation of the Policy;</li> <li>• Provide proposals and inputs in the review of the Policy and tax laws; and</li> <li>• Provide necessary information or such other assistance as it may be required by tax and customs administration.</li> </ul>
Academic and Research Institutes	<ul style="list-style-type: none"> <li>• Provide support for timely and topical research focused on tax matters.</li> </ul>

## **CHAPTER SIX MONITORING AND EVALUATION**

The implementation of this Policy will be tracked using set financial and non-financial indicators. The National Treasury will prepare an implementation matrix of the Policy. The activities will be implemented and monitored through annual work plans of the implementing agencies. The National Treasury will track implementation of the Policy. The Policy will be reviewed after every 5 years or any other period as may be determined by the National Treasury in consultation with stakeholders.