



TAXING FOR A MORE EQUAL KENYA

A FIVE POINT ACTION PLAN TO TACKLE INEQUALITY

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A five point action plan to fight inequality

Extreme inequality is out of control in Kenya. Less than 0.1% of the population (8,300 people) own more wealth than the bottom 99.9% (more than 44 million people). Tackling inequality could help to lift millions out of poverty, secure sustainable economic growth and bring the country together. Inequality is not inevitable and the government can reduce it to sustainable levels. If Kenya increased its tax-to-GDP ratio by 3 percentage points in 2014 it could have raised enough additional funds to ensure quality healthcare for all Kenyans. By delivering on our five-point action plan to tax and spend effectively, the government will ensure a more equal and prosperous future for all Kenyans.

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SUMMARY

EXTREME INEQUALITY IN KENYA MUST BE TACKLED

Today Kenya is a vibrant and growing lower-middle income economy, with GDP growing on average 5.6% annually since the 2008 financial crisis. However, the benefits of growth are not being shared equally. The number of super-rich in Kenya is one of the fastest growing in the world. It is predicted that the number of millionaires in Kenya will grow by 80% over the next 10 years. In a decade, Kenya is forecast to rank third only to South Africa and Egypt for playing host to the highest number of super-rich on the African continent.

However, while a minority of super-rich Kenyans are accumulating wealth and income, the fruits of economic growth are failing to trickle down to the poorest. Poverty still affects millions of people's lives. In 2014, 40% of Kenyans – or approximately 19 million people – were categorized as poor in the Multidimensional Poverty Index, and 13% – approximately 6 million people – were categorized as 'destitute'.

The most recently available data shows that in 2005 the richest 10% of Kenyans earned 38% of total income. The poorest half (50%) collectively earned just 19%. Adjustments of official Gini figures to take account of top incomes suggest that Kenya's income Gini (a measure of income inequality) could be as high as 51.8 – the highest in East Africa. A 2014 New World Wealth survey found that less than 0.1% of the population (8,300 people) own more wealth than the bottom 99.9% of the population (more than 44 million people).

Horizontal inequality (inequality between different groups), such as gender inequality, is prevalent in Kenya and it is important to understand in order to capture inequalities between different groups as well as individuals. Unequal access to opportunities, such as healthcare and education, is also rife. For example, in 2008 almost all children from rich households in Nairobi went to school, while 55% of poor girls living in the North-East had never been to school. There are also wide regional disparities. For example, in Nairobi, average household monthly expenditure is Kenya Shillings 7,200 per adult equivalent, while in Wajir and Turkana, it is Kenya Shillings 1,440.

This extreme inequality is not inevitable, and Kenya must fight inequality to:

- **Reduce poverty.** Research by Oxfam in 2014 found that if inequality remained at the same level for the following five years, 2.9 million more people could be living in extreme poverty than if Kenya reduced its Gini coefficient by just five percentage points.
- **Sustain economic growth.** Extreme inequality undermines economic growth. A 2015 International Monetary Fund (IMF) study found that reducing inequality can boost growth in sub-Saharan African countries. A 2017 paper by the IMF found that inequality harms growth when it increases above a Gini of 27%, which is significantly below Kenya's current Gini. To meet its Vision 2030 goal of securing sustainable growth, Kenya must reduce inequality.

- **Bring the country together.** Extreme inequality undermines social cohesion and is a threat to a stable democratic system in Kenya. According to the UN, extreme inequalities manifested in Kenya contributed to the 2007/2008 post-election violence. Following a series of divisive elections in Kenya in 2017, the government can help to bring the country together by tackling the gap between the ‘haves’ and ‘have-nots’.

FISCAL POLICY COULD DO MORE TO TACKLE INEQUALITY

Fiscal justice – progressive taxation to redistribute and raise revenue for essential public services – is vital to tackle inequality. Taxation directly reduces post-tax inequality levels and strengthens the social contract. For fiscal policy to be truly effective in reducing inequality, it needs to do two things: ensure progressive taxation redistributes at the point of collection and then again when spent on inequality-reducing public services. However, Kenya is ranked 94th out of 152 countries in the world in Oxfam’s Commitment to Reducing Inequality Index (CRI), which ranks states on what they are doing to tackle inequality (Table 1). Kenya scores lowest in the East Africa region for its public spending, for example, spending less than 6% of the budget on health. It also scores the lowest in the East Africa region for progressive taxation.

Table 1: The position of East African countries in the Commitment to Reducing Inequality Index

Country	Spending on Health, Education and Social Protection rank	Progressive structure and incidence of tax rank	Labour market policies to address inequality rank	CRI rank
Tanzania	118	24	92	78
Burundi	73	76	116	88
Rwanda	123	81	73	93
Kenya	131	88	53	94
Uganda	127	68	94	117

Kenya relies on tax revenue as its main source of domestic revenue, with tax receipts averaging 91.5% of the total revenue (not including aid and grants) between 2011/12 and 2016/17. Kenya’s low share of non-tax revenue is welcome, because tax revenues tend to be more stable than non-tax revenues. However, tax collection is still insufficient to meet the country’s needs. Calculations by Oxfam suggest that if Kenya had increased its tax-to-GDP ratio by 3 percentage points in 2014 it could have raised enough additional funds to ensure quality healthcare for all Kenyans.

Successive tax reforms have taken place in Kenya over the past 30 years, with the government attempting to shift the focus from progressive direct taxation to regressive indirect taxation. However, despite this, Oxfam analysis shows a trend to indicate that direct taxation is making up a higher share of total tax revenue, which is welcome.

It is also notable that the contribution of wealth taxation to Kenya’s total tax revenue is negligible, which is severely restricting the tax system’s revenue base. Capital

gains tax is set at only 5% and is applied solely to the transfer of immoveable property (land, buildings) and unquoted shares. There is no inheritance tax or net wealth tax. Property taxation includes withholding tax on rental income, stamp duty and CGT.

Oxfam's analysis of the personal income tax (PIT) system over the past 30 years shows that while the poor are paying less PIT now than 30 years ago, reductions in the number of tax bands and tax rates for higher earners has led to a concomitant reduction in PIT for the rich. This is despite recent evidence by the IMF that suggests increasing tax rates for the rich has no effect on growth. The effective PIT rate of Kenyans who earn KShs7m reduced by over 50% from 63.2% to 28.8% between 1988 and 2017. The average salary for a CEO in Kenya is \$114,000 per annum (or KShs11,767,650), but they will pay the same top tax rate of 30% as someone earning KShs47,059 from 2018. Furthermore, the value of women's unpaid care work remains unrecognized in the tax system. Oxfam's analysis of the VAT system in Kenya suggests that exempting basic commodities from VAT has reduced the regressivity of the tax as the whole, which is welcome. However, exempting non-food items from VAT has benefited the rich more than the poor, as the rich are more likely to buy these products.

Kenya, like many developing countries, relies more heavily on corporate tax revenue than developed countries. Kenya's statutory corporate income tax (CIT) rate is relatively high, but the effective tax rate of companies is often lower, and Kenya must resist any temptation to lower CIT rates. Kenya has introduced various tax incentives, despite little cost-benefit analysis of the effects, and a World Bank survey revealing that 93% of investors in East Africa would have invested even if tax incentives had not been on offer. Incentives on offer in Kenya include export processing zones, special economic zones and investment deduction allowances. The licensing process for incentives is prone to abuse because of weak regulation and oversight. It has been estimated by Economic Secretary Geoffrey Mwangi that Kenya is losing \$1.1bn every year to all tax incentives and exemptions – nearly twice its health budget in 2015/16 (see note 149).

Corporate tax dodging is undermining Kenya's tax base. According to the Washington-based think tank Global Financial Integrity, Kenya lost as much as \$435m annually between 2002 and 2011 to trade mis-invoicing. Despite strong efforts to tackle transfer pricing abuse, the problem remains.

Despite the threat that tax havens pose to Kenya and its neighbours' revenue base, the government has set up the Nairobi International Financial Centre (NIFC), described by civil society as Africa's newest tax haven. It runs the risk of encouraging more illicit financial flows out of Kenya, depriving the country of vital revenues to invest in reducing inequality and poverty.

INVESTMENT IN EQUITABLE PUBLIC SERVICES IS NEEDED

Kenya needs to increase tax revenues to increase investment in public services. The provision of free, good quality public health and education services to all is critical to reduce economic and social inequalities and boost sustainable economic

growth. Evidence from the OECD shows that public services are successful in tackling inequality, and that the 'virtual income' provided by public services reduces income inequality in these countries by an average of 20%.

However, despite some improvements in health status over the last decade, and the right to health enshrined in the national constitution, progress remains too slow and health inequality unacceptably high. The mortality rates of infants and the under-fives were halved between 2003 and 2014, which is welcome, but the most recent Demographic and Health Survey found that 25% of the population regularly lack access to healthcare. The richest women in Kenya are three times more likely to give birth in safety with a midwife present than the poorest women. Fee charging remains commonplace across the country. Cases of patients, including new mothers, being detained in health facilities for not paying their fees have become national scandals. One example is of a Kenyan policewoman who was recently detained in hospital following the death of her prematurely born twins, due to an outstanding health bill. She was not even able to bury her twins until the bill was settled.

The Government of Kenya can and must do better. It has made a welcome commitment to achieve universal health coverage by 2030. However, when aid for health is deducted, the government spends only 6% of its budget on health – less than half the 15% Abuja spending target agreed by all African governments. In the region, this compares with 11% in Rwanda, 12% in Burundi, 8% in Uganda and 8% in Tanzania.

Privatization is threatening gains made in education. Primary school enrolment rates have improved significantly over the last two decades, rising from 62% in 1999 to 85% in 2012, and gender parity has been achieved at primary level. This progress has been partly due to strong government investments in public education during this period, along with the Free Primary Education (FPE) policy. However, nearly one million primary school-aged children are still out-of-school – the ninth highest number of any country in the world – and large disparities exist between the poorest and richest children. Kenyan households face significant out-of-pocket costs in accessing education, and fees are known to disproportionately exclude the poorest children and girls. Concurrently, Kenya has seen a rapid growth in the establishment of low-fee private schools. The largest for-profit chain of low-cost private schools, Bridge International Academies (BIA), operates more than 400 schools in Kenya. Commercial low-fee schools rely largely on unqualified, low-waged teachers and technology to deliver scripted, standardized lessons, an approach which is likely to undermine a holistic, quality education. They also fail the affordability test for the poorest, making them the wrong choice to increase access in such deprived areas.

Kenya does rank higher in its level of expenditure on education than other countries in the East African Community. However, in the early 2000s, expenditure was significantly higher and has gradually fallen each year since, despite rising need. For example, at its peak in 2005, education accounted for 27.5% of total government expenditure. Yet in 2015 spending on education as a percentage of total spending was 16.5%. This falls short of the 20% needed to ensure the education system is properly funded.

TIME FOR REFORM: A FIVE-POINT PLAN TO TACKLE INEQUALITY

The gap between the richest and poorest has reached extreme levels in Kenya. But extreme inequality is not inevitable, it is a matter of political choice. This is clearly recognized by Uhuru Kenyatta, President of Kenya, when he says:

'Inequality can be tackled. Public spending on high-quality education and healthcare reduces inequality.'

Oxfam is calling on the Kenyan government to develop a national plan to reduce the gap between rich and poor, with clear timebound targets. It must also ensure that national income and consumption data is regularly updated and made publicly available so that inequality levels can be monitored. Oxfam has identified five key steps that the government can take to deliver on such a plan, and reduce inequality in Kenya.

By taxing effectively, it can redistribute income and wealth while raising much-needed revenue to invest in quality, free public health and education services which are proven to reduce extreme inequality. Tackling gender inequality and strengthening the social contract between citizens and the government will also help to turn the tide on inequality. In doing so, the government can help ensure a more prosperous and equitable future for all Kenyans.

1 REFORM THE PERSONAL TAXATION SYSTEM

The government should:

- Reform the personal income tax code by adding further bands for top earners at higher rates, and adjust the tax bands annually in line with inflation;
- Tax capital gains at the same rate as income, and apply the tax beyond immoveable property and unquoted shares to include listed shares and other intangible property.
- Launch a review of wealth taxation, with the aim of: introducing an inheritance tax, introducing a wealth tax, and increasing land rates for the highest value land;

2 END HARMFUL TAX COMPETITION

The government should:

- Refrain from cutting corporate income tax rates any further;
- Cease offering discretionary tax incentives, subject all new tax incentives to rigorous economic and risk assessments, and regularly review all incentives;
- Establish a framework for the conclusion of tax treaties, amend the Treaty Making and Ratification Act to bring tax treaties within the oversight of Parliament, and invest in the training of tax treaty negotiators;
- Create a new cross-ministry taskforce on multinational companies and the ultra-rich to curtail illicit flows;

- Build on strides made to tackle transfer pricing by developing a database of local company comparables and building the capacity of the Kenya Revenue Authority (KRA) and judiciary;
- Work at the regional level to develop a cooperation framework to combat base erosion and profit-shifting. Push for a second generation of international tax reforms, to be conducted by a Global Tax Body at the United Nations;
- Support national, regional and global efforts to promote tax transparency at all levels, including public country-by-country reporting and public registers of beneficial ownership;
- Ensure the NIFC's full participation in multilateral anti-abuse, exchange and transparency initiatives, and ensure that withholding and corporate income tax rates do not contribute to harmful global tax competition.

3 INVEST IN PROVIDING GOOD QUALITY FREE PUBLIC SERVICES FOR ALL

The government should:

- Guarantee free high-quality healthcare for all citizens, removing all user fees in healthcare and raise and allocate sufficient financing for free, quality public education systems according to national education plans;
- Move towards a tax-based health financing system in which taxpayers contribute according to ability and receive support according to need;
- Implement national plans to fund healthcare and education, by spending at least 15% of government budgets on healthcare and 20% on education;
- Implement strict regulation for private sector healthcare and education facilities to ensure safety and quality, and prevent them from stopping those who cannot pay from using the service;
- Ensure that women's health needs are prioritized, sexual and reproductive rights are upheld, and that bilateral aid is not permitted to constrain women's access to reproductive health services;
- Publish a plan to 'eliminate gender disparities in education' and 'ensure that all girls and boys complete free, equitable and quality primary and secondary education leading to relevant and effective learning outcomes' by 2030 in line with Sustainable Development Goal 3.

4 PUT GENDER AT THE HEART OF POLICY MAKING

The government should:

- Implement economic policies and legislation to close the economic inequality gap for women, including measures that promote equal pay, decent work, access to credit, equal inheritance and land rights, and recognize, reduce and redistribute the burden of unpaid care;

- Systematically analyse proposed economic policies for their impact on girls and women; improve data and data disaggregation in national and accounting systems – including below the household level – to monitor and assess such impact (for example on the distribution of unpaid care work);
- Prioritize gender-budgeting to assess the impact of spending decisions on women and girls, and allocate it in ways that promote gender equality;
- Provide universal child and elderly care services, to reduce the burden of unpaid care work on women and complement social protection systems;
- Ensure the provision of gender-sensitive social protection mechanisms to provide a safety net for women, in ways that provide an additional means of control over household spending.

5 STRENGTHEN THE SOCIAL CONTRACT BETWEEN CITIZENS AND THE GOVERNMENT

The government should:

- Roll out civic education on taxation and spending, to ensure that the public are well-informed on fiscal issues;
- Put in place mechanisms that allow and encourage citizen engagement in policy making. The public must take an active role in the formulation of tax and spend policies. The tax policy formation process needs to be transparent to enable this to happen;
- Measure programmes against how well they strengthen democratic participation and the voice of people to challenge economic and social inequalities;
- Require the disclosure of all lobbying activities and resources spent to influence tax policy making.



Photo Credit: Unequal Scenes by Johnny Miller

1 EXTREME INEQUALITY IN KENYA MUST BE TACKLED

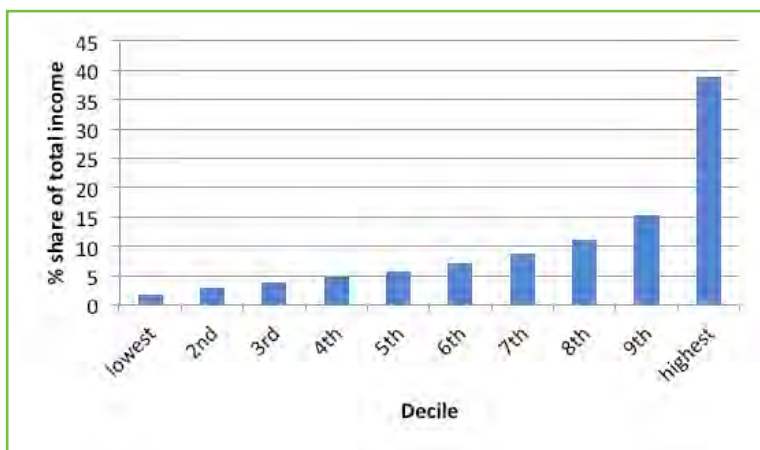
Today Kenya is a vibrant and growing lower-middle income economy². Like most countries, Kenya's economy was harmed by the global financial crisis in 2008. However, since then, GDP has been growing at an average rate of 5.6% per year³. Diariétou Gaye, World Bank Country Director for Kenya, explains, 'Consistent with its robust performance in recent years, once again economic growth in Kenya was solid in 2016 ... This has been supported by a stable macroeconomic environment, low oil prices, earlier favourable harvest, rebound in tourism, strong remittance inflows, and an ambitious public investment drive.'⁴

However, the benefits of growth are not being shared equally. A few at the top are reaping the rewards of the growing economy, and Kenya has one of the fastest growing number of super-rich in the world. It is predicted that the number of millionaires in Kenya will grow by 80% over the next 10 years to 16,900 people. In a decade, Kenya is forecast to rank third only to South Africa and Egypt in the ranking of the number of super-rich in African countries.⁵

While a minority of super-rich Kenyans are accumulating wealth and income, the fruits of economic growth are failing to trickle down to the poorest people. Despite recent economic growth, poverty still affects millions of people's lives in Kenya. In 2014, 40% of Kenyans – or approximately 19 million people – were categorized as poor in the Multidimensional Poverty Index (MPI), and 13% – approximately 6 million people – were categorized as 'destitute'.⁶

The most recent available data on consumption is from the 2005 Kenya Integrated Household Budget Survey. ⁷ Consumption can be used as a proxy for income. This data was recorded prior to the recent prolonged period of growth that Kenya has experienced, and therefore is not necessarily representative of the current situation, yet in 2005, the richest 10% of Kenyans earned 38% of total income, while the poorest half (50%) of Kenyans collectively earned just 19% per cent. The richest 10% of people in Kenya earned on average 23 times more than the poorest 10% (Figure 1).⁸

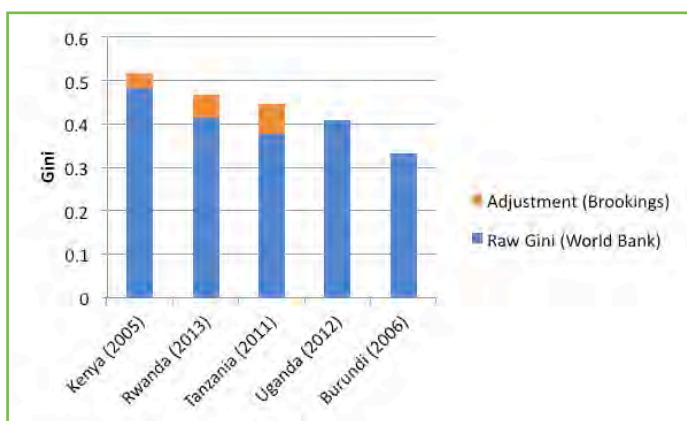
Figure 1: World Bank data, percentage share of income of each income decile based on household survey data 2005, using consumption data



Source: World Bank Povcal Net Database ⁹

Even 12 years ago, the Gini coefficient measuring Kenya’s income distribution was calculated by the World Bank to be 48.5, one of the highest in sub-Saharan Africa. ¹⁰ However, household survey data only provides conservative estimates for inequality levels, because it underestimates the incomes of the richest people. This is generally due to the non-reporting of top incomes, the sheltering of income from the authorities, or other forms of tax abuse. The Brookings Institute use national accounts data to adjust for this missing data from the top income group. Figure 2 below uses calculations by the Brookings institute, which suggest that the Gini coefficient in Kenya may actually be as high as 51.8 – the highest in East Africa.

Figure 2: Brookings Institute data, Gini coefficient measures inequality of income distributions, adjusted for top incomes using national accounts data (2005)



Source: Chandy, L and Siedel, B. (2017), How much do we really know about inequality within countries around the world? ¹¹

Oxfam has been unable to access comprehensive data on the distribution of wealth in Kenya. However, the 2014 New World Wealth Report found that in 2013 less than 0.1% of the population (8,300 people) owned more wealth than the bottom 99.9% of the population (more than 44 million people).¹²

Box 1: The importance of data

Oxfam has been unable to access up-to-date consumption or income data in order to conduct an assessment of current levels of income inequality in Kenya. The most recent available consumption data is from a 2005 national survey. More recent data has been collected by the Kenyan Statistical Office and is due for release in 2017 – 12 years since the previous national survey – but it is not clear when this will be released.¹³

It is essential that all governments keep up-to-date data on consumption and income so that levels of inequality can be tracked. The Kenyan government should publish national survey data at frequent intervals so that up-to-date inequality measures can be attained. The Kenyan government should also focus on improving the data on top incomes.

There is an urgent need for a concerted effort by all governments, supported by international institutions such as the IMF, to collect sufficient data (and sufficiently disaggregated data) to give a timely and accurate picture of the real scale of the gap between the rich and poor.

Inequality is not a question solely of income and wealth. It also concerns horizontal inequality (inequality between different groups), such as gender inequality. It is important to understand horizontal inequalities so that inequality between different groups, as well as inequality between individuals, can be captured. Kenya is ranked 63 on the World Economic Forum's Gender Gap Index, behind its neighbours Rwanda (5), Tanzania (53) and Uganda (61), suggesting that there is considerable room for improvement for gender equality.¹⁴ Inequality of opportunity, such as unequal access to health and education services, is also important. For example, in 2008 almost all children from rich households in Nairobi went to school, while 55% of poor girls living in the North-East had never been to school.¹⁵ Both economic inequality and inequality of opportunity are mutually reinforcing, with unequal opportunities leading to unequal outcomes, and outcomes affecting opportunities for both current and future generations. While both inequalities are interrelated, the focus of this report is on economic inequality, which in turn impacts on other inequalities, making each harder to resolve.

There is also wide regional inequality in Kenya. In terms of consumption, the average household monthly expenditure differs remarkably across the country. For example, in the capital Nairobi, where more employment opportunities are available, average household monthly expenditure is KShs7,200 per adult equivalent, while in Wajir in the North-East, it is KShs1,300.¹⁶ As with the income distribution, poverty varies considerably between regions. In rural areas, (where two-thirds of the population live), 51% of people are MPI (Multidimensional Poverty Index) poor, compared with 17% in urban areas.¹⁷ In Nairobi, less than 5% of people are MPI poor, compared with 83% in the North-East region.¹⁸

WHY KENYA MUST FIGHT INEQUALITY

To reduce poverty

Inequality and poverty are closely interlinked¹⁹. Inequality prevents the benefits of Kenya's impressive economic growth from reaching the poorest and the most vulnerable. The growing numbers of millionaires, when set against a backdrop of staggering poverty, suggests that it is the rich who are capturing the lion's share of the benefits of the country's economic performance, while millions of people at the bottom are being left behind. Inequality undermines the potential of growth to lift people out of poverty. Research by Oxfam conducted in 2014²⁰ found that if inequality remained at the same level for the following five years in Kenya, 2.9 million more people could be living in extreme poverty than if they reduced their Gini coefficient by just five percentage points. If inequality is reduced, millions of Kenyans could be lifted out of poverty.

Figure 3: Poverty projections 2011–19 for different inequality scenarios in Kenya



Source: Oxfam (2014). Even It Up: Time to End Extreme Inequality. Projections assume economic growth continuing at the same level.

To sustain economic growth

The key economic goal of Kenya's Vision 2030 is to sustain high levels of economic growth.²¹ However, this will be much more difficult if the current high level of inequality continues, since it has been shown to severely compromise economic growth. In 2014, research by the IMF concluded that high levels of inequality slow growth.²² A 2017 IMF paper found that inequality harms growth when it increases above a Gini of 27%.²³ By some measures, Kenya's Gini is nearly double this level.

Economic inequality affects growth because a huge segment of the population is largely excluded from economic enterprise. This in turn slows down economic growth, causes the economy to operate far below its potential, and creates a vicious cycle of underdevelopment. Inequality also makes it difficult for the poor to invest in education, which in the long-run has a high social cost by undermining the quality of a country's human resource, and consequently undermines the long-term growth of the economy.²⁴

Studies show that closing the gap between the rich and the poor produces a significant positive impact on the economy. For instance, a 2015 IMF study finds that reducing inequality can boost growth in sub-Saharan African countries.²⁵ A 2014

OECD study indicates that reducing inequality by 1 Gini point would translate to an increase in a country's cumulative growth of 0.8 percentage points in the following five years.²⁶ Furthermore, the IMF has calculated that if countries in sub-Saharan Africa reduced their inequality levels to those seen in ASEAN countries, it would add almost 1 percent to GDP growth, which is equivalent to the impact of closing the infrastructure gap between the two regions.²⁷ Kenya must tackle inequality to meet its Vision 2030 goal of sustaining high levels of economic growth.

To bring the country together

Extreme inequality undermines social cohesion and is a threat to a stable democratic system in Kenya. An unbalanced distribution of income and wealth impedes the realization of equal opportunities for all citizens.²⁸ The growth of a wealthy elite, who then use their economic position to influence policy to their advantage, results in a system that ignores the needs and preferences of many in society. This fuels resentment, and in the long term plays a significant role in the erosion of democratic institutions and systems and the pulling apart of social cohesion.²⁹ Research shows that countries with higher levels of inequality also suffer from higher crime and insecurity levels, among other social ills.³⁰ It is no coincidence that South Africa, a highly unequal country, suffers from runaway crime rates.

Kenya too suffers from similar challenges, with the poorest arid and semi-arid areas bearing the brunt of cattle rustling, banditry and bloody conflicts over resources such as water and pasture.³¹ Regional economic disparities have been blamed as one of the causes of violence in Kenya.³² According to a report published by the United Nations High Commissioner for Human Rights, the extreme inequalities manifested in Kenya contributed to the 2007/2008 post-election violence.³³ According to the report, although the disputed elections provided the trigger for the bulk of the street protests, the underlying inequality which resulted in large sections of the population being denied access to water, food, healthcare, decent housing and employment fuelled the violence further. While more research needs to be done to clarify the connection between inequality and sociopolitical instability in Kenya, it is clear that high levels of inequality are bound to undermine the country's efforts to combat crime, insecurity and myriad sociopolitical challenges. Following a series of divisive elections in Kenya, the government can help to bring the country together by tackling the gap between the 'haves' and 'have-nots'. A clear commitment by the government to tackle extreme inequality would be a good way for the government to begin the healing process.



Catherine Nabulon, Turkana County Kenya. Photo Credit: Joy Obuya/Oxfam

2 FISCAL POLICY COULD DO MORE TO TACKLE INEQUALITY

Fiscal justice – progressive taxation to redistribute income and wealth, and to raise revenues necessary to pay for essential public services – is vital to tackle inequality. The role of taxation in reducing inequality is clearly documented in a number of developing countries.³⁴ Fair taxation can reduce inequality for three key reasons. First, by making the rich pay more than the poor, a progressive taxation system redistributes wealth and income from the ‘haves’ to the ‘have-nots’, thereby directly reducing income and wealth inequality. Second, taxation strengthens the social contract between citizens and state, encouraging citizens to hold their governments to account and ensure that policies work for the many, not the few. Third, tax revenues can fund the provision of free, good quality public health and education services to all, which are critical to reduce economic and social inequalities.³⁵ For fiscal policy to be truly effective in reducing inequality, it needs to ensure that progressive and sufficient taxation redistributes at the point of collection and then again when spent on inequality-reducing public services. Oxfam’s 2014 paper Working for the Many outlines how public services put ‘virtual income’ (the income that people would otherwise have paid out-of-pocket) into the hands of poor people, especially girls and women, and therefore contribute to reducing social, economic and gender inequality.³⁶

However, Kenya’s fiscal system is not doing enough to tackle inequality. Kenya is ranked 94th out of 152 countries in the world in Oxfam’s Commitment to Reducing Inequality Index (CRI).³⁷ The CRI scores and ranks countries on the extent to which

the government executes policies that can narrow inequalities and create fairer societies. Kenya scores the lowest in the East Africa region for its regressive public spending; spending less than 6% of the budget on health, and just over 3% on social protection, which puts it in 131st place globally on public spending.³⁸ It also scores the lowest in the East Africa region for progressive taxation, with the data indicating that Kenya's tax system and collection has a relatively modest impact on the Gini measure for income inequality compared with other countries in the region.

Table 2: The position of East African countries in the Commitment to Reducing Inequality Index

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Rwanda	123	81	73	93
Kenya	131	88	53	94
Uganda	127	68	94	117

If the Kenyan government intends to turn the tide on inequality it must prioritize reform of the fiscal system. It must ensure that the tax system redistributes income and wealth and raises sufficient revenue to enable investment in free quality public healthcare and education for all. This is the focus of this report. However, before continuing, other factors driving inequality in Kenya are highlighted below. In the short term, the government must prioritize fiscal reform to tackle inequality, but in the long term, the following issues must also be addressed if Kenya is to secure a more equal future.

ECONOMIC STRUCTURE

Kenya's main drivers of growth are construction, manufacturing, finance and IT.³⁹ This overlaps with the boom sectors for elite wealth creation in Kenya: real estate, construction and the financial services sector.⁴⁰ The two main sources of the wealth for High Net Worth Individuals (HNWIs, USD millionaires) are real estate (26%) and equities (24%).⁴¹ Furthermore, the locus of economic activity related to these sectors is primarily in the more economically developed regions in Kenya.⁴² Economic development has historically been heavily concentrated along a narrow corridor in the south of the country between Mombasa and Kisumu (with Nairobi in the middle), leaving most of the other areas economically undeveloped. Incomes vary considerably between different regions in Kenya, reflecting the different levels and types of economic activity. For example, Nairobi accounts for just 8.2% of the national population, but 17% of total consumption, while Wajir in the North East with 1.4% of the population consumes only 0.5% of total national consumption.⁴³ Thus, the economic structure of the country is fuelling both wealth creation at the top, and regional inequality, both of which are contributing to economic inequality in the country as a whole.

LABOUR STRUCTURE

Kenya's economic structure has a related impact on income earned from work, which in turn has an impact on inequality. There were 19 million people in the Kenyan labour force in 2016 (40% of the population).⁴⁴ Of these people, 2 million (11%) are unemployed.⁴⁵ The formal sector employed approximately 2.3 million people in 2014, (700,000 in the public sector), which leaves approximately 15 million people working in Kenya's expanding informal 'jua kali' sector, with no formal contract and employment rights.⁴⁶

There are also wide disparities in income earned from labour both within and between urban and rural areas. As reported in the Business Daily, the monthly average minimum wage in urban areas, excluding housing allowance, was between KShs12,136 (all other towns) and KShs15,357 (Nairobi, Mombasa, Kisumu).⁴⁷ After an increase in 2015, average minimum wages in urban areas went up to between KShs13,592 and KShs17,199.⁴⁸ Meanwhile, the top end of earners, for example, those working in the financial sector, were paid an average of KShs83,000 per month in 2014.⁴⁹ Wages are lowest in rural areas, as reported in the Business Daily the average minimum wages for the agricultural industry in 2015 were KShs6,780 a month, with unskilled workers receiving KShs5,436.⁵⁰ Thus, the country's labour structure leads to wide differentials in pay and rights between those working in different sectors, in the formal and informal economy, and in rural and urban areas, which fuels income inequality.

Oxfam research into wage conditions in the cut flower and green bean industries in Kenya found that only 11% of workers interviewed were earning what could be defined as a living wage. Many were struggling to make ends meet and to feed their families.⁵¹

GENDER INEQUALITY

There are also gender disparities for earned income. Survey data suggests that men consistently earn more than women.⁵² Domestic workers (predominantly women) record extremely low wages, equivalent to only about one-third of the average earnings of all informal urban non-agricultural workers.⁵³ Women domestic workers in Nairobi urban settlements are financially vulnerable, with a mean monthly wage of KShs4,864.⁵⁴ This is despite a minimum wage for domestic work, as set by the Ministry of Labour, Social Security and Services, of KShs10,954.⁵⁵

Box 2: The reality of domestic work in Kenya



Margaret Mumbua, 46, a domestic worker stands in the doorway of her employer's house in Eastleigh, Nairobi, Kenya. 2016. Photo Credit: Allan Gichigi/Oxfam

Margaret Mumbua, 46, lives with her four children. She has done domestic work for almost 18 years. The amount she earns depends on her customers:

'Maximum per week I can get is 700 [approx. US\$8]. It's not enough, sure it is not enough. Because there are so many things I'm supposed to do with the money. Schools, even primary school, need money...It's very hard, especially if you have somebody who is sick, you have to go somewhere to get a very small loan to cater for their medicine...We have only one dispensary in Mukuru where you can get free medication. The medicine lasts only two days, then it's finished. If you go to the private hospitals, they charge a lot of money ... In Kenya, domestic workers are the low class, so we have nobody to know about us. Even if you work for somebody and he or she fails to give you your amount, even if you go to the chief's camp, you don't get help...The majority of other domestic workers experience those things...I had a woman I used to work for, where I worked almost two years. One time my daughter was sick. I told her that I would take my daughter to the hospital. That was when my job finished there. She told me, you go for good.'

Margaret is however hopeful that the situation will change when she unites with other domestic workers to form an organization which can represent them. Margaret is the chairwoman in a domestic worker's women's group:

'I feel so happy now we are helping ourselves in that group. We even have savings. We save 50 shillings, every week. At Christmas, we share it so everybody gets some. It helps us, it has helped us very much. Even when somebody has got a problem with his employer, we can organize ourselves and we go to the chief and talk on behalf of that person. It is important [to work together] because when you were alone, you can't make it. With a group, you can make it. NOPE [Oxfam's national partner] and Oxfam have helped us so much, because they have taught our rights when we are working...They are the ones who taught us how to organize ourselves to make those groups, so that we can take our grievances to the authorities. In future, we want a very strong organization in order to take our grievances, like the mistreatment when we are working and low payment, to higher authorities. All workers are workers. We need to be the same. In Kenya the domestic workers are the low class. That gap is not good, because it has resulted in segregation of people and we are all the same...I want to be with the Domestic Workers Group because I want to know my rights when I'm working in other people's houses. If we form a strong group, we can make these things easy. We will be strong when we are many.'

Gender inequality is one of the oldest and most pervasive form of inequality, and it continues to shape Kenyan society and the economy to deny women their rights. Economic and gender inequality are closely linked and mutually reinforcing: the IMF has found gender inequality and income inequality to be closely correlated, in particular where women have less access to their rights over health and education services.⁵⁶ Kenya is ranked 63rd on the World Economic Forum's Gender Gap Index,

behind its neighbours Rwanda (5th), Tanzania (53rd), and Uganda (61st), suggesting there is considerable room for improvement, and has a particularly low rank (116) for women's educational attainment.⁵⁷ It is given a 'medium' score on the OECD's Social Institutions and Gender Index.⁵⁸ Despite welcome attempts to create a 'two thirds gender rule',⁵⁹ whereby not more than two-thirds of members of Parliament can be of the same gender, women are still underrepresented in decision making processes.⁶⁰ Overall, women are underrepresented in positions of leadership and over-represented in low-paid sectors, the informal economy, and unrecognized unpaid work. Given the close relationship between gender inequality and economic inequality, gender inequality must be tackled to reduce economic inequality.

UNEQUAL LAND OWNERSHIP

Land ownership and its distribution remains a key driver of inequality in Kenya. During colonization, European settlers took control of large areas of land and introduced individual ownership. This dramatically changed the land ownership structure, since land was previously held communally. Land quickly replaced the traditional measures of wealth and status. During the decolonization process, the African elite took advantage of the new system of land ownership and amassed vast tracts of land, leaving a large section of the population land-poor.⁶¹ This inequality has increased as the population has grown.⁶² Due to the high unemployment rate in the country and with 74% of the population living in the rural areas,⁶³ a large portion of the population is dependent on land for revenue generation and subsistence. Unequal access to land therefore exacerbates the existing gap between rich and poor by limiting the opportunities available to the poor to better their lives through agriculture.⁶⁴ There is also a gender dimension to unequal land ownership. For example, despite 96% of Kenya's rural women population working on farms, only 6% of the women in Kenya hold title to land.⁶⁵

POLITICAL CAPTURE

Wealth, politics and taxation in Kenya are inextricably linked, and have been for decades. This has given rise to elite capture, whereby elites exercise their power and exert disproportionate influence over laws, policies and institutions for private benefit at the expense the poor and public interest generally. The postcolonial Kenyan state continues to represent a pact of domination between transnational capital, the Kenyan elite and the executive. During the decolonization process, some Africans were recruited to staff the provincial administration.⁶⁶ These Africans eventually captured seats in the legislature and emerged as large-scale farmers and traders. Upon attaining independence, some of these elites became the main beneficiaries of the new regime, and in the process were able to obtain vast amounts of property and land in particular. They were able to maintain this control and reproduce it through their dominance in the legislature. The expectation that the 'indigenous' government would be more patriotic or socio-democratic was ill-founded. Professor Makau Mutua describes the political structure as having been 'specifically organized for the purposes of political repression to facilitate economic exploitation of human and physical resources'.⁶⁷ The inheritors of state power

found themselves at the helm of an extremely well-organized inequality machine that conferred on them immense power. However, it is not only those members of the elite that hold political positions that exert disproportionate influence. The instrumental power of elites stems from their relationship with policy makers, which is achieved through linkages with political parties, institutionalized consultation with government, recruitment into government, election to public office and informal ties. They also have direct access to policy making tools which enable them to align policies with their interests. In the context of structural power, the Kenyan elite have been able to indirectly influence taxation policies through implicit threats of disinvestment or capital flight.

Box 3: Tax exemptions for helicopters and aircraft

In 2013 Kenya enacted a new VAT law which sought to rationalize VAT exemptions as part of a commitment to the IMF in return for their balance of payment assistance to Kenya.⁶⁸ Initially the government attempted to eliminate all exemptions – even those related basic foodstuffs and essential supplies – but this was opposed by the public and MPs.⁶⁹

One curious exemption that was introduced was a VAT exemption on light aircraft and helicopters and their spare parts. Light aircraft and helicopters are often used by the rich elite, including political elites who increasingly own or use helicopters for their political events. During the debate on the VAT bill, a member of parliament who previously worked in the aviation sector, Hon. Capt. Clement Wambugu, successfully lobbied various parliamentary committees to exempt light aircrafts from VAT, arguing that:

‘if this matter is not addressed urgently, operations at the Wilson Airport will grind to a halt soon. Air operators have complained of the punitive taxes and are withdrawing their services from the airport.’⁷⁰

Operators of large aircraft complained about the perceived discriminatory exemption for light aircraft, which according to their industry lobby group the Kenya Air Operators Association are mostly used by the rich for private travel, while big operators like Kenya Airways employ thousands of people.⁷¹ Others also voiced their support in the media for tax exemptions for the sector. They argued that the exemption would reduce the cost of flying and result in an increase in local and international air travel, thereby boosting tourism.⁷² Subsequently large aircrafts were exempted from VAT through the Finance Act of 2014.

A study carried out by New World Wealth indicates that the list of the wealthiest families in Kenya is dominated by a politically connected elite who control over 50% of the wealth in the country.⁷³ According to the list, the Kenyatta, Moi, Karume, Kibaki, Odinga, Nyachae, Kulei, Biwott, Michuki, Saitoti and Mwau families are some of the wealthiest in the country,⁷⁴ as well as being deeply entrenched in the Kenyan political scene, with a number of family members having held senior posts in government. For example, members of the Moi family have been former presidents and senators, while Kibaki was the third president, with Odinga acting as his prime minister and the leader of opposition.

The report further states that at least 20% of the economic elite had strong political ties.⁷⁵ Individuals identified include Manu Chandaria, a stakeholder in the aluminium, steel, plastics and information technology industries; Naushad Merali, who has interests in agriculture, energy and power, finance and telecommunications; James Mwangi, who has interests in banking; Vimal Shah, who has interests in manufacturing and real estate; and Chris Kirubi, who has interests in real estate, manufacturing and investments.



Head Teacher Winnifred Maingi teaches a class at the Reuben Baptist School, in the Mukuru informal settlement, in Nairobi, Kenya-
Photo Credit: Sam Tarling/Oxfam

3 KENYA'S TAX PERFORMANCE

As observed, Kenya's tax system is not doing enough to reduce inequality. The new Kenyan administration has a strong mandate to make meaningful progress on one of the key tenets of the Constitution of Kenya 2010, that 'the public finance system shall promote an equitable society' and further that 'the burden of taxation shall be shared fairly'.⁷⁶ Progressive taxation is vital to reduce inequality both by redistributing income and wealth directly, and by raising revenues to spend on inequality-reducing public services. The potential role of taxation in reducing inequality has been clearly documented in OECD countries,⁷⁷ and in developing countries.⁷⁸ Tax systems, the budget cycle and public spending are the most visible and tangible expressions of the social contract between citizens and state, enabling mutual accountability.

Successive tax reforms have taken place in Kenya over the past 30 years, with the stated aim of improving tax collection, introducing a more progressive structure and increasing competitiveness in business.⁷⁹ In the 1970s, Kenya experienced chronic deficits, primarily as a result of the rise in oil prices, coupled with declining demand for coffee, which is one of Kenya's top export commodities. Persistent revenue deficits exposed the weakness of the country's tax system in raising domestic revenue. In response, the country embarked on the Tax Modernisation Programme in 1986. The key purpose of the programme was to create a sustainable tax system capable of increasing the revenue base to meet the public financing needs of the

country,⁸⁰ along with strengthening tax administration, and making the tax system less complex and more equitable. Prior to the August 2017 election, Kenya's Cabinet Secretary for Finance gazetted The Finance Act 2017, which amends laws relating to various taxes and duties.

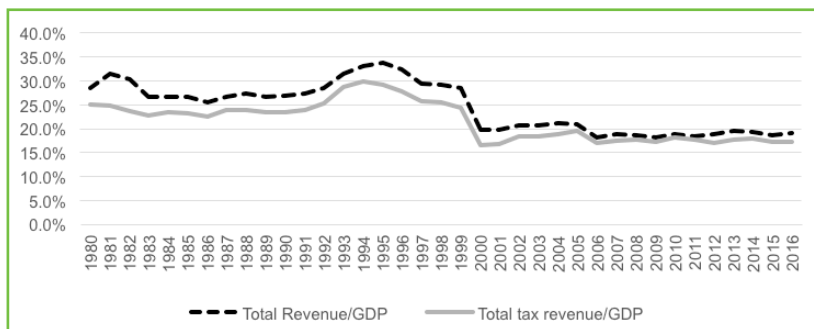
Oxfam has used Economic Surveys produced by the Kenya National Bureau of Statistics to assess over time how much revenue has been raised, through which sources, and ultimately how progressive the tax system is.⁸¹

COULD MORE REVENUE BE RAISED TO FUND ESSENTIAL SERVICES?

Kenya relies heavily on tax revenue as its main source of domestic revenue, with tax receipts averaging 91.5% of the total revenue (not including aid and grants) between 2011/12 and 2016/17. Non-tax revenue includes levies, rates penalties, investments by government, income from government properties and proceeds from sales of goods and services. Comprehensive data on aid and grant revenue was not available for the full period of analysis and so is not included in calculations. However, the share of grants in total revenue is low, estimated at only KShs29.3bn and KShs26.3bn in 2015/16 and 2016/17, which is less than 1% of GDP.⁸² Kenya's low share of non-tax revenue in total revenue is positive because tax revenues are more stable than non-tax revenues.⁸³

Statistics indicate that total tax revenue in absolute terms almost doubled (in line with GDP) between 2011/12 and 2016/17 – increasing from KShs695.9 billion in 2011/12 to KShs1,338.3 billion in 2016/17. However, tax collection is still insufficient to meet the country's needs. Kenya's tax-to-GDP ratio (Figure 4) has remained flat from 2009 to 2016, despite rising growth.

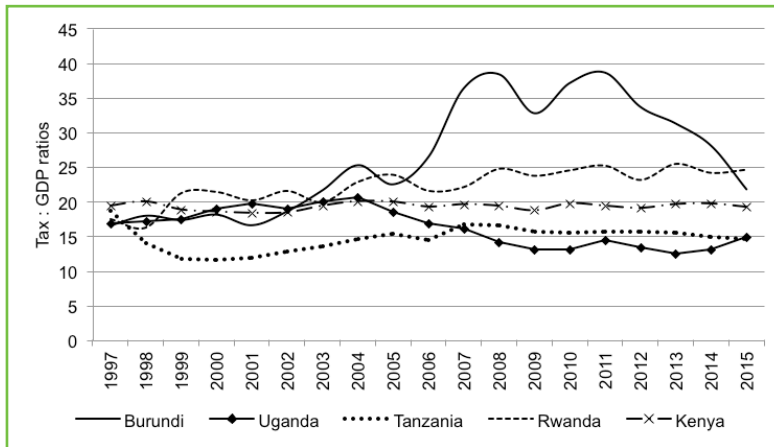
Figure 4: Tax-to-GDP and total-revenue-to-GDP ratios



Source: Author computation using data from Government of Kenya. Economic Survey (various issues)⁸⁴

Kenya's tax to GDP ratio is lower than the heights achieved from the 1980s through to the turn of the century. It is also lower than some of its nearest neighbours (Figure 5). While its tax-to-GDP ratio is higher than Uganda and Tanzania, it is lower than Rwanda and Burundi. IMF analysis that estimated countries' 'tax frontier' (the upper level of tax revenue ratios that can be raised for a given level of economic and institutional development) found that, among the largest countries in sub-Saharan Africa studied, the unexploited tax potential appears particularly sizeable in Kenya.⁸⁵

Figure 5: Tax-to-GDP ratios in East Africa region



Source: IMF (2017) World Economic Outlook Database⁸⁶

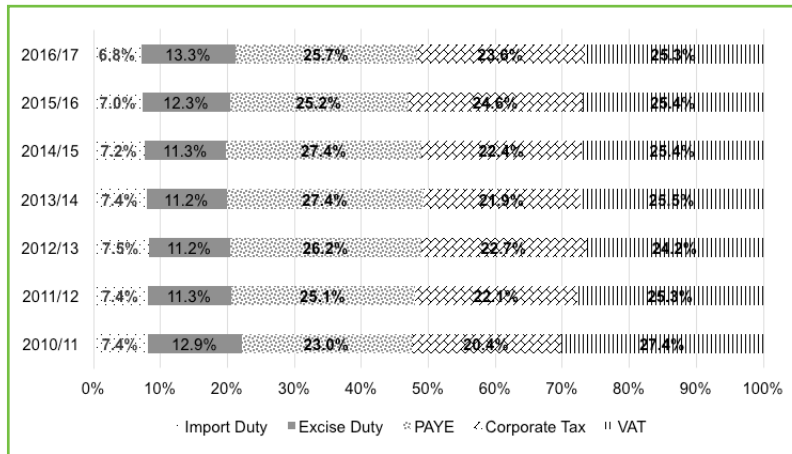
Kenya is in desperate need of revenues to fund vital public healthcare and education services (see later), but it is not collecting as much tax revenue as it could. Calculations by Oxfam suggest that if Kenya had increased its tax-to-GDP ratio by 3 percentage points to 20.9 in 2014 it could have raised sufficient additional funds to ensure universal health coverage for the entire population.⁸⁷ While a 3-percentage point increase in the tax-to-GDP ratio is ambitious, the comparison clearly indicates the benefits of increasing revenue collection. There is clearly both the potential, and urgent need, to increase Kenya’s tax-to-GDP ratio to raise revenues for essential public services.

THE COMPOSITION OF KENYA’S TAX BASE

One of the primary reasons for the lack of growth of Kenya’s tax-to-GDP ratio is the narrow sources of tax revenue contributing to the total tax base. Taxes on wealth (particularly capital, assets and finance), especially in those sectors associated with Kenya’s economic growth, is minimal and is not being exploited to redistribute or raise revenue. A lack of formal employment opportunities is also restricting the personal income tax base. Further, a reduction in tax rates for those paying tax limits the amount of revenue that can be raised. As will be seen later, tax incentives and illicit financial flows are further undermining the tax base.

The composition of Kenya’s tax base is shown in Figure 6. Total PAYE⁸⁸ tax revenues increased in absolute terms from KSh174.8bn in 2011/12 to KSh343.8bn in 2016/17. However, the share of PAYE of total tax revenue only slightly increased from 25.1% in 2011/12 to 25.7% in 2015/16. While a small increase in the share of PAYE is positive, it is a concern that the tax base is so reliant on personal income tax collected from a small number of income tax payers relative to the total population. It is estimated that KRA’s taxpayer base stands at 2.9 million active taxpayers out of the 8.1 million taxpayers registered in the personal identification number (PIN) database, with a significant proportion of taxpayers being non-filers, nil-filers or credit filers.⁸⁹

Figure 6: Tax composition as a percentage of total tax revenue



Source: Government of Kenya, Economic Survey (various issues)

Collection of Corporate Income Tax (CIT) increased in absolute terms from KShs154.1bn in 2011/12 to KShs316bn in 2016/17. CIT revenue as a percentage of total tax revenue increased slightly from 22.1% of total tax revenue in 2011/12 to 23.6% in 2016/17. This share compares well with low-income and lower middle-income countries, where corporate income tax comprises a significant share of total tax receipts – around 18% in 2010.⁹⁰ It compares even better to that of the OECD average, which stood at 8.8% in 2014.⁹¹ Corporate income tax is enormously important to developing countries as they rely more on CIT collection as a percentage of total revenues because their tax bases are so narrow in terms of sources, and with relatively few taxpayers in number.⁹² It is a positive development that CIT is making up such a large share of revenue. Despite this, like most countries, it is unlikely that Kenya is exploiting the full tax potential of corporates.

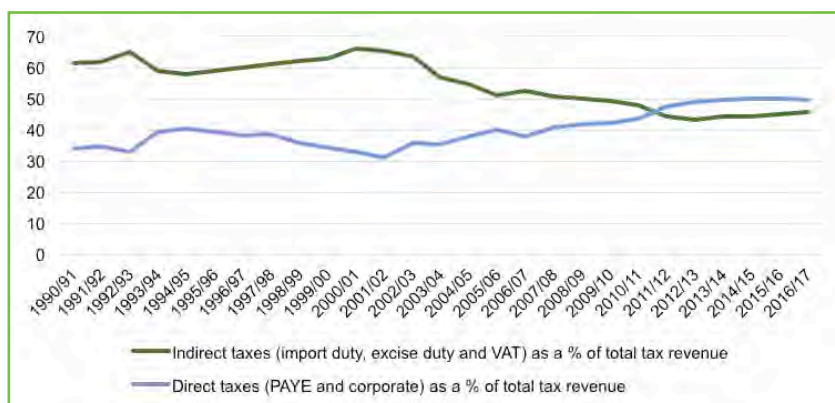
Value added tax (VAT) has stagnated at around 25% of total tax revenue over the five-year period, although VAT revenue collection in absolute terms increased from KShs176.4bn in 2011/12 to KShs338.7bn in 2016/17.

It is notable that the contribution of wealth taxation to Kenya’s total tax revenue is negligible, which is restricting the tax system’s revenue base and severely limiting its redistributive effect. There is no inheritance tax or wealth tax. The only property taxation in place is a small land tax and a 5% capital gains tax on the sale of properties. Tax revenue collections from Capital Gains were low at KShs578.95m, KShs3,810m and KShs3,051m in 2014/15, 2015/16 and 2016/17 respectively.⁹³

The Tax Modernisation Programme of 1986 attempted to shift the taxation away from direct taxes towards indirect taxes. The argument from the government for this policy was that indirect taxes like VAT have a less adverse impact on investment and exports.⁹⁴ Further, it was argued that indirect taxes have a high revenue potential, and that their collection and administration could be more economic, efficient and expedient.⁹⁵ Such efficiency objectives could be challenged, however, by the poor redistributive effect of consumption taxes, which fall more disproportionately on the poorest.⁹⁶ Despite the reforms, analysis by Oxfam shows that there has been a trend towards direct taxation making up a greater share of total tax revenues than indirect taxation since the turn of the century (see Figure 7). This is welcome, as direct

taxation of individuals and corporates is far more progressive than indirect taxation, which tends to hit the poorest hardest.

Figure 7: Direct and indirect taxes as a percentage of total tax revenue over time (not including 'other taxes')



Source: Government of Kenya, Economic Survey, Various Issues

Box 4: Oxfam’s Domestic Resource Mobilisation Project



Volunteer Azulu Adeba, 44, in his local area where he carries out tax monitoring work with the National Taxpayers Association in Kiambiu, Eastleigh, Nairobi, Kenya. 2016. Photo Credit: Allan Gichigi/Oxfam

Oxfam in Kenya is helping to fight economic inequality in Nairobi, Turkana and Wajir through the Domestic Resource Mobilisation (DRM) project, which was publicly launched in January 2016. The project aims to tackle inequality and poverty in Kenya through policy influencing to broaden the tax base, as well as on-the-ground monitoring of revenue allocation and spending, improving people’s knowledge of tax issues and their rights, and encouraging citizens to hold their leaders to account.

Azulu Adeba, 44, is an activist working with one of Oxfam’s partners – the National Taxpayers Association. He says: ‘I got involved with the project because I started wondering where my taxes go....Our constitution guarantees the right to information. That includes whatever is passed by our leaders. We have a right to know how the taxes we pay are being used. It is important to follow up on taxes, because we pay taxes to improve, if not sustain, the country’s economy. The taxes levied are to build the nation and not to enrich certain people...People in the community pay taxes whenever they buy anything. Be it milk or sugar, everything that one buys is taxed by the government (VAT). In addition to that, small-scale traders here are also required to pay taxes to the local authorities so that they can run their businesses...These taxes should be used on primary concerns, such as better roads. You can see for yourself how impassable these roads can be. If it was someone coming to ferry a pregnant woman to hospital, they would have a hard time being able to access the woman. She won’t receive the attention she requires due to the state of the roads...If the taxes we pay were used accordingly I believe a lot would change with regard to inequality. A better economy would in turn create more employment opportunities which would in turn improve people’s ability to sustain themselves and their families.’



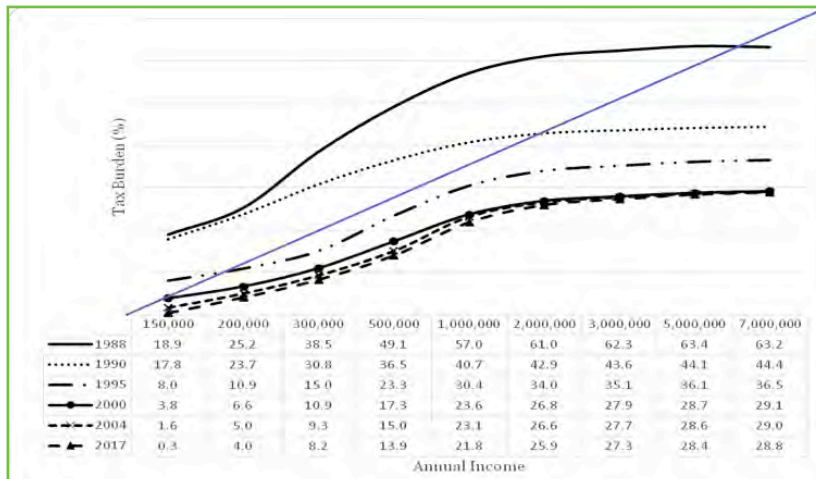
Josephine Njeri, 38 sells her homemade goods by the roadside in Kawangware, Nairobi, Kenya 2016. Photo Credit: Allan Gichigi/Oxfam

4 IS KENYA'S PERSONAL TAX SYSTEM PROGRESSIVE?

PERSONAL INCOME TAX

Personal income taxes (PIT) are levied in Kenya as legislated under the Income Tax Act of 1974. The income tax structure is scheduled, meaning that different types of income attract different rates. Under successive PIT reforms, significant changes in income tax brackets and rates took place between 1988 and 2017, notably, a reduction in the number of tax brackets and the reduction of tax rates for top earners (see annex 1). Plotting the effective PIT rate for different incomes over time gives an indication of how progressive the tax system was at different periods in time (Figure 8). The most progressive tax system would be one in which those earning lower incomes have a lower tax burden, while those earning higher incomes have a higher burden.

Figure 8: Effective personal income tax progressivity



Source: Oxfam calculations using tax rates, thresholds, and tax relief. See annex 1 for further information.

From the analysis above, we can see that the gap in tax contribution between the lowest income earner (KShs150,000) and the highest income earner (KShs7m) has widened between 1988 and 2017, with the tax contribution of the highest earner being three times the tax contribution of the lowest earner in 1988, compared with 100 times in 2017. This is welcome, as is the fact that those on lower incomes have seen their effective PIT rate decrease. However, while the tax system may have become more progressive across low-income brackets (more so in recent years), the level of progressivity has declined in the high-income brackets, with top earners seeing their effective PIT rate reduce over time too. For example, the effective PIT rate of someone earning KShs7m more than halved from 63.2% to 28.8% between 1988 and 2017. Furthermore, a reduction in the number of tax bands has meant that the rich and super-rich are being taxed at the same rates, which limits the system’s progressivity. Based on survey data, it is estimated that the average salary for a CEO in Nairobi is \$114,000 per annum (or KShs11,767,650), but they will pay the same top tax rate as someone earning KShs564,710 from 2018, despite earning 20 times more. Therefore, the progressivity trend over time is mixed. While the effective personal income tax rate of the poorest is lower, which is welcome, taxation of the rich and super-rich has become much less progressive. Recent evidence by the IMF suggests that increasing tax rates for the rich does not hurt economic growth.⁹⁸ The ongoing review of the Income Tax Act provides an opportunity to make the personal income tax system more progressive. The government should add more bands at the upper end of the PIT brackets and increase the top rates to ensure that the rich and super-rich are paying their fair share.

In response to higher food costs and the cost of living rising as a result of inflation, the government has proposed in the Finance Act of 2017 to further review the current income tax brackets. With the expansion of the tax bands by 10%, the lowest taxable income for low-income earners will rise from KShs11,180 per month to KShs12,298 per month.⁹⁹ In addition to this, increases in tax relief have effectively exempted many low-income earners from paying tax. For example, in 1997/8, tax relief was KShs7,920 per annum, which had increased to KShs15,360 per annum in 2016/17.¹⁰⁰ Increasing tax relief leaves poorer people better off, even preventing some falling into poverty, and so is welcome.

Prior to the amendments introduced by the Finance Act 2016, which expanded the tax brackets, the brackets had remained static since 2004. This is despite the erosion of income due to inflation. If the income brackets are not adjusted periodically, taxes can go up substantially, simply because of inflation. Unlike with other taxes such as excise, the Income Tax Act does not provide for annual inflationary adjustments. Rather, adjustments to the tax brackets are at the discretion of Parliament. The Income Tax Act should be amended to provide for annual inflationary adjustments to cushion the lower income-earning persons from inflationary increases and to ensure that the tax system sustains over time.

Box 5: Honour among legislators

The impact of direct participation of the elite in policy making was felt with regards to the taxation of income of MPs. MPs' current salaries range from KShs710,000 to KShs1,320,000 (depending on seniority), plus generous allowances and benefits.¹⁰¹ In 1975, MPs legislated that their allowances would not be subject to tax and that only their basic pay, which formed only a quarter of their total income, would be subject to income tax.¹⁰²

In 2006, the Finance Minister Amos Kimunya sought to introduce, through the 2006/7 budget speech, the taxation of these allowances. The proposal did not make it to the Finance Bill, as it was voted out by MPs during parliamentary debates. Mr Kimunya sought to reintroduce the proposal in the 2008/9 budget speech to Parliament. His proposal was premised on the need to reduce inequality among Kenyans.¹⁰³ Again, the proposal was rejected by Parliament.

The rejection of the proposals sparked public outcry. In a bid to appease the public, a few MPs volunteered to pay tax. Mr Kimunya faced the wrath of parliamentarians for this proposal. Shortly thereafter, he was implicated in a corruption scandal and subsequently lost a vote of no confidence that was passed almost unanimously.¹⁰⁴ Interestingly, it is one of the few times that a vote of no confidence against a minister has ever succeeded.

The new Constitution of August 2010 made it unconstitutional for any law to exclude any state officers from paying taxes.¹⁰⁵ In spite of the provisions of the new Constitution, the MPs rejected attempts to make them pay taxes, relying instead on a gentleman's agreement that had been entered into by the KRA, then President Mwai Kibaki and then Finance Minister Uhuru Kenyatta. According to the agreement, MPs would continue to receive their income free of tax until the next elections were held and a new Parliament was sworn in in 2013. The MPs sworn in after 2013 would then be subject to tax on their income. This agreement was entered into on the advice of the then Attorney General Amos Wako. The KRA, however, continued to demand taxes despite their earlier agreement.¹⁰⁶

Reverend Timothy Njoya, an activist, instituted a suit against the MPs. The suit sought to have them compelled to pay taxes in line with the provisions of the new Constitution.¹⁰⁷ The High Court, in finding for Reverend Njoya, held that MPs were required by law to pay their fair share of taxes. To comply, the MPs' outstanding taxes were paid by the government out of the Consolidated Fund, as set out by the 2010/11 budget.¹⁰⁸ To offset the effect on their incomes of the tax, MPs increased their salaries.¹⁰⁹

Changes to PIT rates and brackets have also not been sensitive to gender disparities. For example, reduced tax rates for top earners are most likely to benefit men, since women are underrepresented both in paid employment and in the highest paying jobs. Women are, however, overrepresented in the informal sector and in unpaid work, particularly poorer women, where they will receive no benefit from reduced tax rates. Although they are untaxed directly in this work, they still have to pay consumption taxes. Currently, Kenya does not have a child/dependants' subsidy or allowance in its tax system for women who are in formal employment and also provide unpaid care work. As such, the value of women's unpaid care work remains unrecognized, which creates gender inequality, as men, who generally do not provide the same level of unpaid care work, are taxed at the same level as women. To correct this, Kenya should consider introducing a tax allowance for women in employment who are also engaged in providing care work.

VAT

Consumption taxes, such as value added tax, are considered to be regressive because those on low incomes spend a higher percentage of their income on consumption than those on higher incomes. Furthermore, because they are flat-rate, everyone pays the same, which means that the cost as a percentage of total income is higher for those on low incomes. Kenya's VAT structure has changed over time, both in terms of the range of goods and services that are taxable and the rate structure.

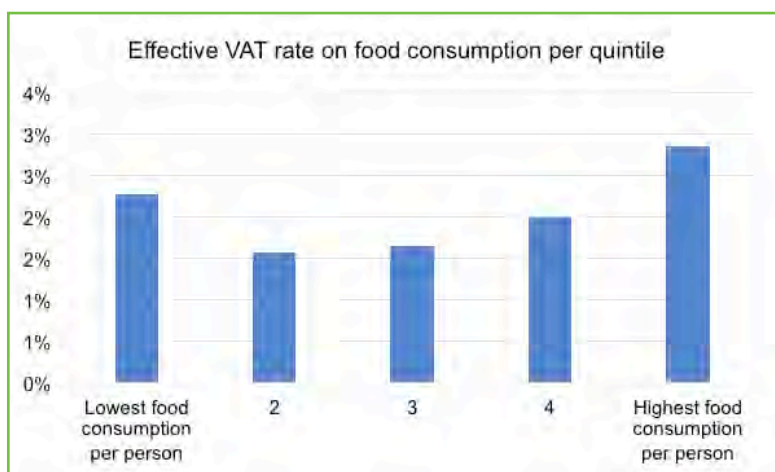
VAT was introduced in Kenya in 1990 as a replacement for the sales tax, and was charged on taxable supply of goods and services produced locally and imported into Kenya. Under the VAT Act, there are three different classes of goods and services: designated, zero-rated and exempt.¹¹⁰ The term 'zero-rating' is used in VAT law to refer to supplies of goods and services that are subject to tax but taxable at the rate of zero percent. The zero-rating concept was introduced in the VAT system to enable exporters, manufacturers and suppliers of zero-rated goods and services to claim refund of tax paid on inputs incurred in dealing with zero-rated supplies. Examples of zero-rated supplies include all exports, supplies to pharmaceuticals manufacturers and bread. Some commodities are considered exempt under VAT. Exempt supplies are not taxable and do not form part of the taxable turnover. Persons who deal exclusively in exempt supplies are not liable to register and cannot claim input tax on these supplies. Exempt supplies include financial services, insurance, education and health (including veterinary) services, sanitary services, agricultural services, and social welfare services. Designated goods and services are those that are taxable at the standard VAT rate.

While VAT by its nature is regressive, its inequitable impacts can be mitigated somewhat by exempting or zero-rating commodities that are essential to poorer people. For example,¹¹¹ Kenya has exempted sanitary pads from VAT, and in 2016 exempted all the raw materials used in their production from VAT and other duties. Kenya has exempted some basic food commodities (such as milk, eggs, meat, fruits – see annex), and some basic services, such as health and education, which has made the VAT less regressive (see Figure 9). The Finance Act (2017) has introduced further zero-rating on essential items. For example, a zero-rate status for maize

flour and bread was introduced, allowing manufacturers, wholesalers and retailers to lower the cost of production for these commodities. However, it is not guaranteed that manufacturers will pass on the lower costs of production to consumers.

Oxfam has analysed the impact of VAT exemptions and zero-rating on household budgets across income groups using household data on consumption patterns from the Kenya Integrated Household Budget Survey (KIHBS 2005)¹¹². See annex 2 for the methodology and further detail. Figures 9 and 10 show the VAT burden of different income groups when consuming food and non-food products.¹¹³ Without any zero-rating or exemptions, the tax burden for the different quintiles would all be close to 16%.¹¹⁴ The results show that, on the whole, exempting and zero-rating food items from VAT makes VAT more progressive. Furthermore, data on the share of a household's income spent on food items was not available, but it is likely that the poorest households spend a greater share of their income on food items and so any food exemptions are more likely to benefit the poorest. However, as can be seen in Figure 9, the very poorest people have a slightly higher effective tax rate than people in the middle of the distribution, and so more could be done to ensure that food products consumed by the poorest people are fully exempt/zero rated.

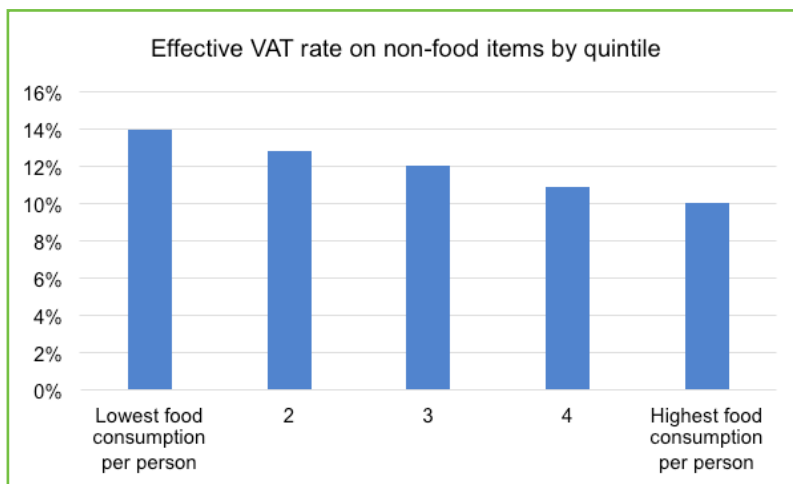
Figure 9: Food consumption VAT burden as a percentage of total food expenditure by quintile



Source: Author computation from KIHBS (2005).

The reverse overall picture was found to be true for non-food consumption, whereby exempting non-food consumption benefited the rich more than the poor. This is because richer households consume a more diverse variety of non-food commodities compared with those in poorer households.

Figure 10: Non-food consumption tax burden as a percentage of total non-food expenditure by quintile



Source: Author computation from KIHBS (2005)

EXCISE TAX

Excise tax (often referred to as excise duty in Kenya) is another type of consumption tax but is payable by manufacturers, rather than by final consumers. However, the cost is usually passed on to consumers. It is often levied on alcoholic beverages and cigarettes, and sometimes referred to as a ‘sin tax’ as it can play a positive role in disincentivizing unhealthy consumption. It can also have redistributive impacts when it is charged on luxury items, which wealthy people are more likely to consume in higher volumes. Due to its low administrative costs and the substantial revenue collected from it, excise tax is often the go-to tax for the government to raise extra revenue, and is levied on few products at high rates. However, excise tax as a share of total tax revenue has remained stable, averaging at 10% over the past five years in Kenya. Currently, excise duties in Kenya are applied to alcoholic beverages, tobacco, fuel, personal financial transactions (such as ATM withdrawals and mobile money transactions), cosmetics, motor vehicles and other smaller excisable commodities such as mineral water, matchsticks, etc. Motor vehicles, mobile airtime and financial transactions are taxed on an ad valorem basis (a percentage of the final product price), whereas excise taxes on beer, cigarettes and petroleum are charged on a specific basis (e.g. Kshs10 per litre rather than a percentage of the final price). The Finance Act (2017) increased the duty on high-value spirits and branded cigarettes. Consumption data on excisable commodities is not well captured in household survey data and so it has not been possible to conduct an analysis of the progressivity of excise tax. While it would be expected that taxing luxury products would be progressive, many lower income men and women consume products that are subject to excise duty, such as cigarettes, and so the picture is not clear.

WITHHOLDING TAXES

Withholding tax is tax levied on certain types of passive income such as dividends, royalties, management fees among others. It is imposed at source, with the person

making the payment for the service being required to deduct the tax due and remit the amount to the KRA. Withholding taxes can help to reduce tax evasion since at least part of the tax is collected before the person receives the payment. It also reduces the cost of collection for the revenue authority since it places the obligation to withhold on the person making the payment. In the case of payments to persons who are not resident in Kenya, withholding tax allows KRA to tax non-residents with minimal effort. Without withholding tax, it would be difficult for the KRA to track non-residents and retrieve tax on any income they made in Kenya. Withholding taxes range from 5% (applicable on dividends) to 20% (applicable on royalties). The rates vary depending on whether the payment is made to residents or non-residents. The rates tend to be higher for non-residents.

In a bid to promote foreign direct investment, the Finance Act (2017) amended the Income Tax Act to exempt and introduce lower rates of withholding taxes on various payments made in special economic zones (see page 35) to foreign investors. The amendments eliminated withholding tax on dividends paid by special economic zones to foreign investors. The amendments further reduced the withholding tax payments in special economic zones in the form of interest (falling from 15% to 5%); management and professional services (falling from 20% to 5%); and royalties (15% to 5%), effective from 1 January 2018. For the Kenyan government, this might be an attempt to attract foreign investment, but the impact for the country can translate into significant revenue loss, an increase of artificial profit shifting, and an exacerbation of tax competition with neighbouring countries.

In 2014, the IMF found that withholding tax rates have gone down as a result of tax competition over the past decades; 'since the 1980s, tax treaty withholding tax rates on dividends, interest and royalties have on average fallen by about 30%, while the average rate on participating dividends has fallen almost 50%'.¹¹⁵ In 2016, ActionAid analysed more than 500 tax treaties signed since the 1970s and concluded that many treaties have led to significant tax revenue losses for developing countries, including as a result of reduced withholding tax rates.¹¹⁶

CAPITAL GAINS TAX

Capital gains tax is a tax on the profit when something (an 'asset') that has increased in value is sold (or 'disposed of'). It is the gain made that is taxed, not the amount of money received. Taxing capital gains is highly progressive because wealthier people are far more likely to own and trade assets that gain value (such as property, land, artwork, shares, etc.), and therefore profit when they are sold.

Kenya suspended its capital gains tax in the mid-1980s with the stated aim of attracting investments in property and securities (Nairobi Stock Exchange) markets. However, in 2013 the government initiated a review of the capital gains tax under the Income Tax Act, in an endeavour to improve equity in the tax system. The capital gains tax subsequently was reintroduced in 2015 as a tax that was chargeable 'on the whole of a gain which accrues to a company or an individual on or after 1 January 2015 on the transfer of property situated in Kenya, whether or not the property was acquired before 1 January 2015'.¹¹⁷ Capital gains are subject to tax at the rate of 5%. This rate is low compared with the rest of the region: Tanzania levies a capital

gains tax of 10%, while Uganda taxes capital gains at the same rates as personal and corporate income tax.¹¹⁸ The rate is minimal compared with the top marginal rate of 30% percent top rate on labour, and 16% payable on VAT.

Box 6: Capital gains tax in Kenya – resistance from the elite

The history of capital gains taxation is symptomatic of the challenges that Kenya faces in its attempts to tax the elite. Capital gains tax was first introduced in 1975 as a response to the growing demands for equity and redistribution by seeking to tax the wealthy.¹¹⁹ The tax was popular with the public but faced very vocal opposition from Members of Parliament (MPs) and other elites who had to bear the weight of the new tax.¹²⁰ MPs argued that it was unfair to tax capital gains and that the tax would dissuade the holders of capital from investing in Kenya.¹²¹ The rate was reduced from the initial 36% to 10% and a broad-based sales tax introduced (which was then replaced by VAT in 1990) to meet the growing gap in revenues. The introduction of the sales tax heralded the beginning of the subtle shift of the tax burden from the elites to the poor.¹²² Those lobbying for the abolition of the capital gains tax obtained some reprieve when the tax was suspended in 1985.

Years later, various attempts to reintroduce the tax were shut down by MPs. The first attempt was in 2006 when then Minister of Finance Amos Kimunya included a proposal in the Budget Speech to reintroduce the tax in the Finance Bill. The proposal was shut down by MPs, who argued that the tax would stifle the property market. The next attempt was in 2013, when the Cabinet Secretary for the National Treasury included it in his budget statement to Parliament, stating: 'the Government has initiated a review of the Capital Gains Tax ... This will allow wealthier members of our society to also make a token contribution towards our national development agenda.'¹²³

Inexplicably, the recommendation did not appear in the Finance Bill 2013, which was tabled in Parliament after the delivery of the budget statement.¹²⁴ Attempts to introduce it during the parliamentary debate on the issue were shut down by MPs. One of the MPs, John Mbadi, in arguing in favour of the reintroduction of the tax, alluded to the capture of the tax policy process by the elite. In his arguments to Parliament, he stated that:

'I have realized that it is very difficult, painfully so, to tax the rich in this country. It is not true that if you introduce capital gains tax, it will affect adversely the capital market in this country ... Remember before 1985, we had it but because members of this House, a good number of them were in real estate business, they decided to keep the benefits ... This is completely unacceptable, it defeats the very essence of equity ... In this country, the moment you try to tax the rich, they will come up with all manner of arguments, like it is going to discourage investment or you are scaring away investors. Who are these investors? It is us. It is you and I. These Hon. Members are protecting themselves; let them not pretend that they are protecting investments.'¹²⁵

The tax was eventually reintroduced through the Finance Act 2014.¹²⁶ In what appears to have been a compromise, the tax was introduced at a much lower rate of 5%.¹²⁷ The law which came into effect on 1 January 2015 applied to gains made from the sale of property as well as those made from the sale of equities including listed securities. Gains made from the sale of any land in towns and agricultural land above 50 acres are subject to capital gains tax.

The reintroduction of the lower rate of tax faced opposition from players in the capital markets. The Kenya Association of Stockbrokers and Investment banks (KASIB) issued a press statement threatening to suspend trading at the Nairobi Securities Exchange (NSE) until the issue was resolved. Foreign investors also displayed their structural power immediately. During the first quarter following the introduction of capital gains tax, the trade volume at the NSE dropped by over 70%. Unrelenting, KASIB resorted to the threat of disinvestment and aggressive lobbying. KASIB mobilized a consortium that included the Institute for Certified Public Accountants of Kenya (ICPAK), Kenya Bankers Association (KBA), KASIB, and KAM to issue a lobby document that advocated for the removal of the capital gains tax on gains made from trading in listed securities, arguing that the NSE was still young, needed to attract investors, and the introduction of the tax was likely to repel investors.¹²⁹

The government attempted to reach a compromise with KASIB through the introduction of a lower rate of 0.3% withholding tax on gains from listed securities in the 2015 Finance Bill. Eventually, faced with the risk of losing investors and the aggressive lobbying, the government gave in to the demands and through an amendment in the Finance Act exempted gains from listed securities from tax.¹³⁰

An increase of the capital gains tax rate could go a long way to help reduce the inequality exhibited in taxing capital at a lower rate than labour. Furthermore, it would help reduce tax avoidance and evasion and the resultant erosion of the tax base. The discrepancy in the tax rates for income and capital gains encourages tax dodging by allowing corporations and individuals to recharacterize their income as capital gains and therefore benefit from the lower tax rate.¹³¹

OTHER WEALTH TAXES

The analysis of the composition of Kenya's tax base shows that the structure of the system is not levying taxpayers according to their ability to pay. Those who accumulate income and wealth on capital and financial assets they own or from which they benefit are not taxed proportionate to their level of income and wealth. Taxes on wealth, including recurrent taxes on wealth and property, and inheritance taxes, are an important tool to address inequality, since they are highly progressive, targeting only the richest group in society. Moreover, they are vital to prevent excessive concentrations of wealth and power in the hands of a few,¹³² and to ensure greater equality of opportunity across generations.

The only form of wealth tax levied in Kenya beyond capital gains is property tax, which takes the form of land rates payable to county governments, but the contribution of property taxes to total tax revenue remains very low. There is no inheritance tax, and no tax on accumulated capital or assets, such as a wealth tax. Inheritance tax is less economically distortionary than many other tax measures,¹³³ and would reduce the amount of wealth that wealthy families can pass on to their children. A wealth tax would clearly play a role in redistributing wealth from rich to poor.

Kenya should draw lessons from Sierra Leone on how to utilize property tax in raising income to fund local government expenditure. Sierra Leone instituted reforms of its property tax in 2006, including fresh mapping and revaluation of properties.¹³⁴

Following reforms, revenues collected increased.¹³⁵ Kenya should, like Sierra Leone, embark on a reform of its property tax. It should begin, just as Sierra Leone did, by mapping and revaluing land in order to base the tax on the current market price rather than by drawing on the historical and often inaccurate valuations currently in use.



Nairobi Business District. Photo Credit: Kevin Wabungo/Oxfam

5 ARE CORPORATIONS PAYING THEIR FAIR SHARE OF TAX IN KENYA?

Kenya, like many developing countries, relies more heavily on corporate tax revenue than developed countries.¹³⁶ This is because developing countries tend to have a narrow tax base, with fewer taxpayers within the population, and limited diversity in the sources of tax revenue. As a result, corporate income tax occupies a relatively large share of total revenue. This does not, however, mean that corporates are paying their fair share in tax, or that their potential tax contribution is fully exploited. The Kenyan government, like many others, is eager to show corporations that it is 'open for business', and offers a low-tax environment to attract investment, despite the lack of evidence to show that such policies bring positive impacts to the country as a whole.

One of the key drivers fuelling the global inequality crisis is corporate profit-shifting to tax havens to avoid taxation, and harmful tax competition resulting in a race-to-the-bottom in the taxation of global corporations.¹³⁷ For all governments, unduly favourable corporate tax regimes are the result of political choice. Governments choose to pass on the tax burden left unpaid by large corporations to labour, small- and medium-sized businesses, or consumers. In doing this, they are also opting to forego potential revenues that can finance robust social and economic

infrastructure, the presence of which, ironically, is more likely to influence investment decisions than a low-tax environment.¹³⁸

Taxing companies, particularly successful multinationals, is one of the most progressive forms of taxation. Corporate tax rules can be designed to ensure that companies pay their fair share of taxes as a measure to redistribute income downwards. This requires policies that prevent companies escaping their obligations to the societies in which they operate and where they generate their profits.

CORPORATE INCOME TAX RATE

At a global level, competition through corporate tax rate reduction has been considerable over the past few decades¹³⁹. Statutory corporate tax rates are, however, only nominal, and systemic tax minimization arrangements (loopholes, exemptions, etc.) often greatly impair the effectiveness of corporate tax rates. Nevertheless, overall, the nominal rate of marginal corporate income tax clearly does have some significance. Compared with many countries worldwide, and on the African continent as a whole, the corporate income tax (CIT) rate in Kenya is relatively high. It is set at a flat rate of 30% for local companies, and 37.5% for foreign companies.¹⁴⁰ Africa's average top marginal corporate income tax rate is 28.53%, the highest rate among all regions of the world, with the worldwide average being 22.5% (or 29.5% weighted average by GDP) in 2016.¹⁴¹

If the Kenyan government's aim is to promote equity in the tax system and to increase revenue, it must resist any temptation to lower CIT rates in future tax reforms. Corporate tax cuts do not automatically translate into better tax compliance or significantly increased revenues. There is also a lack of any strong evidence that tax cuts increase foreign direct investment (FDI). Many studies cite factors that are more important in attracting FDI, including skills levels in the local economy, the availability of infrastructure and macroeconomic stability, all of which are facilitated by a well-resourced state that can invest to improve these conditions.¹⁴² If a corporate tax cut were to be implemented, it is likely to further narrow Kenya's fiscal capacity to finance much-needed health and education spending. However, CIT rates are not the only policy tool which minimizes foreign corporate investors' tax contributions to the country.

TAX INCENTIVES

Developing countries often use a range of tax incentives, including tax holidays or exemptions, to attract FDI.¹⁴³ Tax incentives can play a positive role in attracting investment, or helping a country shape its economy, but in order to do so, they must be transparent, well designed, and not introduced in response to pressure by vested interests. However, far too often, tax incentives have been found to be ineffective and costly¹⁴⁴.

Evidence suggests that the overall economic characteristics of a country are more important in attracting foreign investments. A survey of investors in East Africa carried out by the World Bank, for example, revealed that 93% of the investors would have invested anyway even if tax incentives had not been on offer.¹⁴⁵ Other

non-tax factors, such as return on likely investment, play a significantly greater role in determining the location of a particular investment.¹⁴⁶ Rather than stimulate economic growth, tax incentives erode the tax base, because the government ends up foregoing tax that they would have otherwise gained had they not offered the incentive, with minimal effect on investment activity. This reduces overall revenues available to fund public healthcare and education services. According to the IMF, 'the proliferation of incentives is largely a manifestation of international tax competition – which regional coordination can help mitigate'.¹⁴⁷

Over the years, Kenya has introduced various tax incentives. While it is difficult to provide an exact figure for the cost of tax incentives due to the lack of transparency about which incentives are available, it was estimated by Economic Secretary in the National Treasury Geoffrey Mwau that Kenya loses \$1.1bn every year to all tax incentives and exemptions – nearly twice its health budget in 2015/16.¹⁴⁸ The licensing process in Kenya is prone to abuse because of weak regulation and oversight. Legislation governing most incentives in Kenya bestows wide discretionary powers on the licensing authorities. The laws do not specify the minimum investment required, nor do they set a minimum shareholder requirement, and there is no minimum requirement for the proportion of local people employed. There are no measures in place, for example, to prevent an entity that completes its 10-year tax holiday from winding up and registering afresh, thereby continuously benefitting from the tax holiday. Similarly, there are no measures that prevent the elite from having disproportionate influence over the licensing processes and ensuring that their own companies are licensed to operate within the EPZs or SEZs in order to enjoy the tax holidays.

The corporate tax incentives on offer in Kenya include the following.

Export Processing Zones (EPZs)

The export processing zones are areas designated for the manufacture of exports. Kenya introduced the Export Processing Zones (EPZs) in 1990 as part of the Export Development Programme. The aim of the EPZ was to transform the economy through increased production of goods for exports. The areas are treated as being outside the customs territory of Kenya as far as taxes are concerned, which entitles companies operating in the EPZs to numerous tax benefits:

- A 10-year corporate tax holiday for the first 10 years of operation, meaning they pay no corporation tax in this period;
- After the 10-year holiday, EPZ entities are subject to a reduced CIT rate of 25% for another 10-year period;
- Exemption of imports from import duty as well as VAT;
- All goods and services supplied by local persons to the EPZ entities are treated as exports and are therefore subject to zero-rated VAT;
- Exemption from stamp duty, which is a tax on the transfer and/or registration of certain assets such as land, shares among others;
- Foreign directors are exempt from income tax.

The EPZ authority is granted powers to determine which entity qualifies to operate in the EPZ territory. The law provides wide discretionary power to the EPZ authority in this regard; no minimum level of investment or minimum local shareholding requirement is provided in the law.

Special Economic Zones (SEZs)

The Special Economic Zones Act 2015 introduced special economic zones (SEZs) in Kenya. The definition offered for SEZs is quite similar to that of EPZs. A SEZ is defined as a designated area where 'business-enabling' policies, different land uses, and infrastructure and utilities are provided, and shares many similarities with an EPZ. However, unlike EPZs, which are intended for manufacturing, SEZs cover a wider range of sectors, including: livestock zones; business service parks; science and technology parks; information communication parks; agricultural parks; and tourist and recreational zones. As such, it is much easier to meet the entry requirement of an SEZ. Much like the EPZ authority, the SEZ authority has wide discretionary powers to determine which entity qualifies to be an SEZ.

SEZs enjoy wide tax incentives. These include:

- Reduced corporate taxes of 10% for the first 10 years, then 15% for the subsequent 10-year period;
- Dividends paid to non-resident shareholders are exempt from tax;
- Management, training and professional fees payments made by an SEZ enterprise to non-resident persons are taxed at a reduced rate of 5%;
- Royalties or natural resource payments made by an SEZ to non-residents are subject to tax at the reduced rate of 5%;
- Interest on loans paid by an SEZ to a non-resident person is subject to a reduced tax rate of 5%;
- Exemption of imports from import duty as well as VAT;
- All goods and services supplied by local persons to the SEZs are zero-rated for VAT purposes;
- SEZ enterprises within Nairobi, Mombasa and Kisumu are entitled to a 100% investment deduction for buildings and machinery;
- SEZ enterprises outside of Nairobi, Mombasa and Kisumu are entitled to a 150% investment deduction for buildings and machinery.

Changes in the Finance Act of 2017 mean that transactions between SEZ entities and other entities in Kenya will be subject to transfer pricing regulations. This is welcome, as it will make it more difficult for companies to shift profits into the SEZs.

Investment Deduction Allowances

To encourage investments, Parliament introduced investment deductions in 1988. Investment deductions allow investors to deduct the cost of the capital investment from their profits, and are intended to incentivize companies that invest heavily in machinery and buildings. However, due to the high cost of machinery and buildings,

the investment deduction normally wipes out any taxable profits. The deduction was at the rate of 60% of the cost of the machinery, building or equipment.¹⁵¹ Over the years, the rate has increased to 100%. A special rate of 150% was introduced in the 2009 Finance Act.

Currently, the Income Tax Act provides for the following investment deductions:

- A deduction of 100% of the cost of equipment with respect to investment in the construction of industrial buildings or the installation of machinery and equipment in a building.
- Construction of a building for an amount of more than KShs200m outside of the municipalities of Nairobi, Mombasa or Kisumu is entitled to an investment deduction at the rate of 150%. This incentive was intended to boost investment and manufacturing outside the Central Business District. However, it remains to be seen if there has been tangible movement in this regard or whether it is just another tool that perpetuates economic inequality.

TAX DODGING IS UNDERMINING THE TAX BASE AND INCREASING INEQUALITY

Multinational corporations are able to use tax loopholes to dodge paying their fair share of taxes. Corporate tax dodging is facilitated by a global network of tax havens. Tax havens are complex, harmful and opaque tax structures spanning different continents that enable profit to be shifted from the tax jurisdictions where their economic activity takes place to low-tax jurisdictions.¹⁵³ The result is an increasingly eroded tax base, with a contracting share of corporate income tax to total revenue. Kenya has not been spared from this. Trade mis-invoicing is just one type of corporate tax abuse, and involves intentionally misstating the value, quantity, or composition of goods on customs declaration forms and invoices.¹⁵⁴ The motive could be to evade taxes, avoid customs duties, transfer a kickback or launder money.¹⁵⁵ According to Global Financial Integrity, between 2002 and 2011, Kenya is believed to have lost as much as \$435m revenue annually on average to trade mis-invoicing.¹⁵⁶

In a bid to counter transfer mispricing,¹⁵⁷ another common form of corporate tax abuse, Kenya has established a transfer pricing regime. This regime, alongside those of South Africa and Egypt, has had great success and serves as a model for other African countries.¹⁵⁸ However, despite the successes of the transfer pricing regime, Kenya still faces challenges in implementing transfer pricing rules. These include the lack of local company comparables that can be used in determining the appropriate arm's-length price for transactions. The KRA and taxpayers are thus forced to rely on comparables from other countries and adjust these to the local situation, meaning that the prices may not be a true reflection of the arm's-length price for Kenyan businesses.¹⁵⁹ There is need to develop a database of local company comparables to help accurately determine the arm's-length price.

Another key challenge that has been identified is the capacity of the judiciary and, to some extent, within the KRA, although the latter has provided extensive training

for its staff in an attempt to meet these concerns. The situation is more acute within the judiciary, where the judges tasked with making decisions on complex transfer pricing matters are not well versed in the technicalities of the topic. Capacity development of both the judiciary and the KRA would be a useful step in overcoming this challenge.

DOUBLE (NON-)TAXATION AGREEMENTS

Double taxation agreements (DTAs) are intended to reduce the incidence of double taxation on income earned in one country by a resident of another country. They can be useful to ensure that the income earned by multinationals is not subjected to taxation by both the source state and resident state. They also enhance cooperation among tax administrations, especially in tackling international tax evasion.¹⁶⁰ Despite this, tax treaty agreements often include loopholes for companies to exploit for tax evasion and avoidance purposes.

Section 41 of Kenya's Income Tax Act grants the Cabinet Secretary to the National Treasury the power to declare by way of notice any agreement or arrangements entered into by the government of Kenya with any other country, with a view of affording relief from double taxation. Kenya has entered into several double tax agreements with various countries, including: Canada, Denmark, France, India, Korea, Norway, Qatar, Sweden, Zambia, Mauritius, and the United Kingdom.¹⁶¹

Whereas double taxation agreements are meant to bring a number of benefits, if they are not properly structured, they can do more harm than good.¹⁶² This is especially true for DTAs that contain provisions harmful to domestic resource mobilization and that inadvertently facilitate illicit financial flows.¹⁶³ These are prone to abuse, especially so in developing countries, where expertise on negotiation and implementation of tax treaties is limited. Kenya, as is the case in most developing countries, does not have a policy or structure on negotiation of tax treaties.¹⁶⁴ Tax treaties are negotiated at the whims of the executive, as tax treaties are not included in the Treaty Making and Ratification Act, which provides for parliamentary oversight of treaties. This leaves room for abuse, as the executive may opt to have Kenya negotiate and ratify treaties with countries that offer them or their fellow elite strategic advantages. Such treaties may offer greater benefits than intended to investors and may lead to the erosion of profits from Kenya. Box 7 illustrates how the Kenya–Mauritius tax treaty enables the shifting of profits made in Kenya to Mauritius, which operates as a tax haven.

Box 7: Tax treaties: Shifting profits to tax havens

The Kenya–Mauritius tax treaty has been criticized for eroding the tax base and shifting profits made in Kenya to a tax haven.¹⁶⁵ An example is in the area of capital gains. Taxing rights for income from the sale of shares in companies is taxable in the resident state of the seller. This means that, where the holding company is located in Mauritius, as is likely to be the case, then the sale of the shares of a subsidiary located in Kenya will be taxed in Mauritius, where there is no capital gains tax. This is a real threat to the tax base of Kenya, as the highest percentage of foreign direct investment into Kenya is routed through Mauritius.¹⁶⁶ The Kenyan government, in negotiating the tax treaty, should have taken this into account and demanded for more taxing rights to prevent the shifting of profits from Kenya to Mauritius. However, in a bid to encourage investments and to prevent the flight of foreign investment, Kenya acquiesced to the unfavourable terms of the treaty. Problems with similar agreements have led the governments of South Africa and Rwanda to renegotiate their respective DTAs with Mauritius.¹⁶⁷

In October 2014, Tax Justice Network-Africa (TJNA) sued the Government of Kenya, challenging the constitutionality of the Kenya/Mauritius Double Taxation Avoidance Agreement. According to TJNA, the Agreement significantly undermines Kenya’s ability to raise domestic revenue to underpin the country’s development by opening up loopholes for multinational companies operating in the country and super-rich individuals to shift profits abroad through Mauritius to avoid paying the appropriate taxes. For example, provisions under Article 11 of the Agreement relating to interest limit Kenya’s withholding tax to 10%, while the Kenyan domestic rate currently stands at 15%. TJNA further argued that the Agreement was inconsistent with the principles of good governance, sustainability and accountability. The Agreement, they further argued, was open to abuse, and this could endanger the growth and development of Kenya.

Additionally, provisions under Article 20 of the Agreement reserves all taxation of ‘other income’ not dealt with in specific Articles to the residence state. This effectively reduces withholding tax to zero percent on services, management fees and insurance commissions. This will lead to massive revenue leakages. TJNA avers that the Agreement is neither United Nations- nor OECD-compliant and that it also fails to address the issue of disposal of shares in companies.

Under the Agreement, foreign investors in Kenya can acquire Kenyan companies through Mauritius holding companies, but Kenya cannot tax any of the gains when they sell these businesses again. Similarly, domestic Kenyan investors can dodge Kenyan taxes by round-tripping their investments illicitly through Mauritian shell companies. Kenyan companies can also easily avoid Kenyan taxes in dividends paid to foreign investors, through devices like share buy-backs. The provision is very similar to the Capital Gains Tax Article in the India–Mauritius treaty, which has proved particularly controversial, costing India an estimated US\$600m a year in revenues as a result of tax avoidance and illicit round-tripping by Indian business executives. This has driven the government of India to initiate steps to renegotiate its Agreement with Mauritius.

The hearing was concluded, but the court is yet to deliver its judgment on the matter.

Further research by Oxfam in Kenya shows the use of tax havens, such as the Netherlands, Luxembourg and Mauritius,¹⁶⁸ in the ownership structure of Kenyan petroleum rights.¹⁶⁹ Oil companies commonly use subsidiaries in tax havens in order to minimize tax payments in both the countries in which they operate and the jurisdictions where they are headquartered. Kenya is not yet a petroleum-producing country, and pumping oil may still be some years off. The risk to government revenues from the widespread use of subsidiaries in tax havens lies in the future.

In preparation for that prospect, the government should be alert to these risks, as companies are incurring significant exploration expenses that will be recoverable if and when oil production begins. Care should be taken to review existing Double Taxation Agreements in order to ensure that benefits are not flowing to conduit companies that are not among the intended beneficiaries. Multinational oil companies should be required to publish financial results for each country where they have a presence (so-called country-by-country reporting). Kenyan subsidiaries should be required to publish their annual financial statements. This will greatly increase public transparency on potential profit shifting.

NAIROBI: AFRICA'S NEWEST TAX HAVEN

The Nairobi International Financial Centre (NIFC) is described by civil society as Africa's newest tax haven, based in Nairobi and signed into law by the president on 21 July 2017. Civil society organizations are concerned that Nairobi's IFC will facilitate tax dodging by companies and individuals in Kenya and worldwide, driving the global race to the bottom in taxation.¹⁷⁰ Tax Justice Network-Africa (TJNA) are concerned that the NIFC will result in large corporations paying zero or low taxes and could be used to launder money. Jared Maranga, Policy Lead of the tax and investment programme at TJNA, said:

'[the NIFC] will undermine the raising of revenues domestically, making Kenya a financial secrecy jurisdiction and is subject to abuse given that neither the regulations nor the incentives have been indicated ... oversight of the companies will also be difficult since the proposed law will be centred on the president.' (March 2017)¹⁷¹

A steering council led by the president and his deputy, as well as an oversight authority headed by an appointee of the president, Treasury, and Cabinet secretaries, is to be created. The NIFC law is superior to any other financial law, which could bring unfair treatment and make companies in the financial centres beyond reproach. The NIFC has been modelled on the Qatar Financial Centre, where companies pay no withholding taxes, enjoy highly slashed/no corporate tax rates, and pay no tax on capital gains. It runs the risk of encouraging more profit shifting out of Kenya, and the continent as a whole, depriving the country of vital revenues to invest in quality public healthcare and education services. It is also another step towards the development of a network of tax havens across Africa and its near neighbours for a wealthy elite to exploit for tax abuse and criminal activity.



John, son of Jane Muthoni, in class in Kawangware, Nairobi, Kenya - Photo Credit: Allan Gichigi/Oxfam

6 PUBLIC INVESTMENT IN EQUITABLE PUBLIC SERVICES

The provision of free, good quality public health and education services to all is critical to reduce economic and social inequalities and boost sustainable economic growth. For fiscal policy to be truly effective in reducing inequality, it needs to do two things: ensure that progressive taxation redistributes at the point of collection, and then again when spent on inequality-reducing public services. Governments must commit to prioritizing the financing and delivery of these services. Evidence from the OECD shows that public services are successful in tackling inequality, and that the ‘virtual income’ provided by public services reduces income inequality in these countries by an average of 20%.¹⁷² Free public health and education, funded through progressive taxation, could do the same for developing countries like Kenya and boost the human capital necessary for economic growth and ensure that all Kenyan citizens share the benefits of development. Investing in free education and health is also a proven way to liberate women and girls from the gender inequality that keeps them out of the classroom and prevents them from leading healthy and productive lives free from the disproportionate burden of unpaid care.¹⁷³

HEALTHCARE: IS PROGRESS TOO SLOW?

The transformative potential of free and equitable universal public healthcare cannot be overstated. Everyone has the right to the highest attainable standard of health, including access to all medical services. Women and girls are invariably the last in line for healthcare services when they are either unavailable or unaffordable, and it is they who pick up the unfair and inequitable burden of unpaid care for those whom the government and private sector fail. Inequitable and insufficient public financing of healthcare prevents equitable access to care and results in impoverishing and catastrophic out-of-pocket costs for hundreds of millions of people worldwide. While the wealthy can afford to finance their own healthcare, poor government commitment to health risks plunging middle-income households into poverty and locking into poverty those households which are already poor.

Many ministers of finance prioritize more visible infrastructure and security spending over essential services such as healthcare, yet evidence from 46 African nations, including Kenya, shows that increased and improved investment in women and children's health could save millions of lives and yield an exceptional 11-fold return through social and economic investments.¹⁷⁴ It is estimated that a quarter of all growth in full income in low- and middle-income countries between 2000 and 2011 resulted from health improvements.¹⁷⁵

In Kenya, there have been some welcome improvements in health status over the last decade. For example, under-five mortality and infant mortality rates were halved between 2003 and 2014 due to the increased use of essential health services.¹⁷⁶ Furthermore, the right to health has been enshrined in the Constitution,¹⁷⁷ ensuring that access to healthcare is a key issue of concern for all Kenyan governments. However, progress has not been fast enough, and health inequality remains unacceptably high. Despite the government commitment to the Millennium Development Goals (MDGs) for over a decade, there was no progress at all to reduce maternal mortality – it still remains unacceptably high at one in every 276 live births.¹⁷⁸ The most recent Demographic and Health Survey found that 25% of the population regularly lack access to healthcare.¹⁷⁹

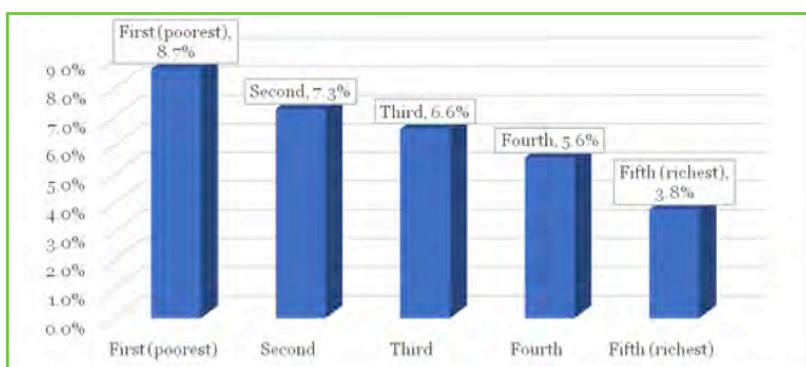
Considerable variations in health status and access to services across regions and income groups reveal stark inequalities. The under-five mortality rate in Nyanza region is double that in Central region.¹⁸⁰ Many women still do not have access to essential primary healthcare services.¹⁸¹ Skilled birth attendance was 22% in Wajir county compared with 93% in Kiambu county.¹⁸² The richest women are three times more likely to have skilled birth attendance than the poorest.¹⁸³

The Government of Kenya can and must do better. It has made a welcome commitment to achieve universal health coverage by 2030.¹⁸⁴ However, public spending remains woefully low and some inappropriate policies risk exacerbating inequalities. The government spends just under 6% of its budget on health¹⁸⁵ – less than half the 15% Abuja spending target agreed by all African governments.¹⁸⁶ In the region, this compares with 11% in Rwanda, 12% in Burundi, 8% in Uganda and 8% in Tanzania.¹⁸⁷ Such low levels of government spending not only block urgently needed progress on improving efficiency, quality and coverage but expose all Kenyan

citizens, especially middle- and low-income households, to the risk of impoverishing and catastrophic costs for health in the form of user fees and high medicine costs. A recent study estimated that nearly 2.6 million Kenyans fall in to poverty or remain poor due to ill health each year.¹⁸⁸

In Kenya, 32% of total health expenditure comes straight from peoples' pockets at the time of need.¹⁸⁹ This is the most regressive way of paying for healthcare. As Figure 13 shows, the proportion of non-food household expenditure on healthcare for the poorest households (8.7%) is more than twice the proportion spent by the wealthiest households (3.8%).¹⁹⁰

Figure 13: Healthcare spending as a proportion of total non-food expenditure among different quintiles



The government has made welcome commitments to remove user fees at primary healthcare facilities and make maternal healthcare free at public health facilities.¹⁹¹ However, failure to ensure compliance to the new policies and to adequately compensate facilities for funding lost, have left Kenyan citizens exposed to unacceptable risks. Fee charging remains commonplace across the country. Cases of patients, including new mothers, being detained in health facilities for not paying their fees have become a scandal and should be a source of national shame.¹⁹² One example is of a Kenyan policewoman who was recently detained in hospital following the death of her prematurely born twins, due to an outstanding health bill. She was not even able to bury her twins until the bill was settled.¹⁹³

Instead of increasing public finance and protecting its citizens and reducing inequality through tax-financed quality free healthcare, the Kenyan government seems intent on pursuing contributory health insurance schemes as a solution. The government's intention is to introduce mandatory health insurance to protect all citizens. While perhaps well intentioned, the model is flawed for a country with high informal employment. Forcing people to pay an insurance premium outside of the formal economy (where it can be automatically deducted through payroll) is not possible. For the vast majority of Kenyans then, insurance becomes de facto voluntary – a choice. The World Health Organization (WHO) is clear that voluntary insurance fails to maximize redistribution of resources from the healthy and the wealthy to the sick and the poor and will not achieve universal health coverage.¹⁹⁴ Ghana's concerted effort to scale up coverage using health insurance should serve as a lesson, as the poorest are least enrolled in the scheme.¹⁹⁵ A recent technical committee tasked with reviewing the Ghana scheme recommended that the government should move to make improved universal primary healthcare free to all in the country and not just to those who have enrolled in the scheme.¹⁹⁶

Both public financing and political will are needed to address severe and long-standing health system challenges and improve quality of care. Governance challenges include poor coordination, poor use of evidence for decision making and weak management capacity.¹⁹⁷ Recruitment and retention of trained health workers, particularly in rural hard-to-reach areas, remains a problem, and there are weak HR management practices across the sector.¹⁹⁸ Health facilities often lack essential commodities, including medicines, due to insufficient funds and inadequate supply chains.¹⁹⁹ All of these challenges are compounded by and further exacerbate poor quality standards in provision, poor data management and inadequate basic infrastructure.²⁰⁰ In Kenya the public sector is the main provider of healthcare services, especially for the poor. Two-thirds of the poor utilize the public sector for their healthcare needs, compared with only about one-third of the richest.²⁰¹ While public primary healthcare services and hospital admissions are pro poor, hospital outpatient services are not, with the richest 20% of the population benefitting more.²⁰² In Kenya, across all wealth quintiles, there is a heavy reliance on public facilities for hospital admissions. In contrast, private hospitals are highly inequitable. Only 10% of private hospital admissions came from among the poorest 20%. This increases to 36% for the richest 20%.²⁰³

These figures are striking. Despite quality and coverage challenges across the public healthcare sector, Kenyans predominately continue to depend on and/or choose to seek care in government services, and overall, these services are progressive. Two key points emerge. In seeking to tackle Kenya's extreme economic inequality through the health sector, the government must prioritize efforts to expand, dramatically improve and remove financial barriers to accessing public health facilities, particularly primary healthcare. This is the equitable route to universal health coverage that will reach the poorest first. On the other hand, the rapid growth of the private healthcare sector in Kenya, particularly in urban tertiary care, should be some cause for concern. With finite human resources for health in the country, the growth in private healthcare companies may result in brain drain from needed public services and further exacerbate inequality in health provision. In this regard, the government should avoid committing any scarce public resources to subsidize commercial healthcare providers (e.g. via tax breaks or subsidized land) to encourage their further growth. Instead, it should improve regulation of the healthcare sector to drive up standards and consider enforcing fair and sustainable recruitment approaches.

EDUCATION: IS PRIVATIZATION THREATENING GAINS?

Universal and equal access to a good quality education is transformative – it tackles extreme economic inequality by providing virtual income, improving social mobility by boosting opportunities including for decent work, reduces poverty, increases participation and autonomy, and helps to build gender equality and women's empowerment.²⁰⁴ A coherent public education system – where education is equitable, free of charge, of decent quality and where there are minimum standards and regulations set by the government – has been vital to ensuring universal access to quality education in all the advanced economies.

Although some important progress has been made in education, Kenya faces challenges in achieving Sustainable Development Goal 4, focused on inclusive and quality education for all and lifelong learning.²⁰⁵ Primary school enrolment rates have improved significantly over the last two decades, rising from 62% in 1999 to 85% in 2012, and gender parity has been achieved at primary level.²⁰⁶ This progress has been partly due to substantial government investments in public education during this period²⁰⁷ and the Free Primary Education (FPE) policy (see Box 8).

However, nearly a million primary school-aged children are still out of school – the ninth-highest number of any country in the world²⁰⁸ – and large disparities exist between the poorest and richest children. For example, using data from 2008, UNESCO found that almost all children from rich households in Nairobi had been to school, but 55% of poor girls living in the North-East had never been to school, and 43% of poor boys in the region had never attended school.²⁰⁹ Enrolments drop off substantially after the transition to secondary school, when the enrolment rate is only 50%, and girls lag behind boys at secondary level.²¹⁰ Kenya's female adult literacy rate was 74% in 2014, lagging almost ten percentage points behind the male literacy rate.²¹¹ Furthermore, education is not of adequate quality to ensure that all children can learn the basics.

Kenyan households face significant out-of-pocket costs in accessing education because school fees are widespread in both public and private schools. These fees – as well as other costs such as uniforms, books and transportation – are known to disproportionately exclude the poorest children and girls, exacerbating economic and gender inequality. In recognition of the negative impact of school fees, in 2003 the government abolished public school fees nationwide through its Free Primary Education (FPE) policy. A surge in enrolments followed the introduction of FPE. However, a lack of forward-planning and adequate school-level financing eventually led to a deterioration in the quality of education provided and the exit of many higher income students from the public system.²¹² Also, despite FPE, Section 29 of the Basic Education Act has allowed public schools to enforce a variety of charges to cover the costs of service provision at the school level. Although it stipulated that no child should be turned away for failure to pay, in practice, these informal fees have contributed to the exclusion of lower income children from accessing public education.

Box 8: Impact of increased public spending on gender inequality

The Free Primary Education (FPE) programme in Kenya is a good example of the impact of allocation of resources to public goods. Free primary education was introduced after the 2003 election following a successful national campaign by civil society. Free primary education was informed by the need to eliminate direct schooling costs which were viewed as barriers to schooling.²¹³ The effect of the programme was immediate. Gross enrolment increased from 6 million in 2002 to 7.6 million in 2006.²¹⁴ Data from KIHBS 2005 indicate that the main beneficiaries of the programme were those from the lower income quintiles, with the bulk of the resources allocated to the programme benefiting the lowest-earning 60% of the population. In addition, during this period, enrolment of girls increased. It is estimated that around 27% of girls in the first quintile benefited from FPE, while 24% of the boys benefited from FPE.²¹⁵ The programme was therefore a win not only for the lower quantiles but also for girls as it helped to reduce the disparity in education levels. In the run-up to 2017 election both the ruling party and the opposition promised to offer free secondary education.²¹⁶

Concurrently, Kenya has seen a rapid growth in the establishment of low-fee private schools, both informal schools as well as commercial chains, particularly in urban slums and some rural areas. These schools charge a small fee relative to traditional private schools, and target lower income families. The largest for-profit chain of low-cost private schools, Bridge International Academies (BIA), operates more than 400 schools in Kenya. Donors and development banks have invested heavily in promoting Bridge and other low-fee schools in Kenya. However, these schools do not comply with Kenyan laws and regulations, including national curriculum standards and requirements for trained teachers, in spite of repeated requests for compliance from the Ministry of Education.²¹⁷

Commercial low-fee schools profit through continual expansion in scale and reduction of costs, which is at odds with the need to invest in schools to achieve quality education. They rely largely on unqualified, low-waged teachers and technology to deliver scripted, standardized lessons, an approach which is unlikely to deliver a holistic, quality education. Despite claims made by their proponents, there is insufficient evidence for better learning outcomes in low-fee schools.²¹⁸ A review by the UK's Department for International Development (DFID), stated, '*there is ambiguity about the size of the true private school effect. In addition, many children may not be achieving basic competencies even in private schools.*'²¹⁹ The World Bank World Development Report 2018 echoed this, stating that there is no reliable evidence showing private schooling leads to better outcomes.²²⁰

Low-fee private schools also fail the affordability test for the poorest, making them the wrong choice to increase access in such deprived areas. For families living in Kenyan informal settlements, sending three children to a BIA school would represent between 44 and 138% of their monthly income.²²¹ In Kenya's Nairobi slums, studies indicate that a lack of access to public education leaves private schools as the only available option, even for low-income households. One study found that the urban poor in Nairobi's Kibera slum were paying for low-fee private schools, while richer families in more settled urban areas were sending their children to better quality public schools.²²²

Both financing and policy choices are undermining the quality and equity of public education provision in Kenya. Kenya's public spending on education as a share of GDP was 5.3% in 2015, and its expenditure on education as a percentage of total government expenditure was 16.5%.²²³ This falls short of the necessary 20% of spending target advocated for by civil society.²²⁴ Kenya does rank higher in its level of expenditure on education than other countries in the East African Community. However, in the early 2000s, education expenditure as a percentage of total government expenditure was significantly higher and has gradually dropped each year since, despite rising need.²²⁵ For example, at its peak in 2005 education spending accounted for 27.5% of total expenditure.²²⁶ Greater investments in sufficient numbers of well-trained and supported teachers, appropriate learning materials and adequate facilities are important steps to ensure quality in public schools.



Yusra Mohammed, 14, attends class at the Reuben Baptist School, in the Mukuru informal settlement, in Nairobi, Kenya, on March 28, 2014. Increased tax revenues could be spent on vital public healthcare and education services which fight inequality. Photo Credit: Sam Tarling/Oxfam

7 TIME FOR REFORM: A FIVE-POINT PLAN TO TACKLE INEQUALITY

The gap between the richest and poorest has reached extreme levels in Kenya. With 7,500 new millionaires set to be created over the next decade, it appears that a minority of wealthy individuals and investors are creaming off the yields of economic growth. While the number of millionaires is growing, millions of people still live in complete destitution.

But extreme inequality is not inevitable, it is a matter of political choice. This is clearly recognized by Uhuru Kenyatta, President of Kenya, when he says *'Inequality can be tackled. Public spending on high-quality education and healthcare reduces inequality.'*²²⁷ Ensuring fiscal justice is key to fighting inequality. However, the taxation system in Kenya could do more to redistribute income and wealth, and to raise revenues to fund essential public healthcare and education services. The government must increase its tax-to-GDP ratio towards the country's maximum tax capacity to ensure revenues are available to invest in public healthcare and education. On the spending side, progress on improving healthcare needs to take place at a faster rate, and the government needs to stop the privatization which is threatening gains made in education.

The Government of Kenya can embark on a new path towards prosperity by developing a national action plan to reduce the gap between the rich and the poor, with clear timebound targets. The government should ensure that national income and consumption data is regularly updated and made publicly available to ensure that inequality trends can be monitored. Oxfam has identified five key steps that the government can take to deliver on such a plan, and reduce inequality in Kenya.

With the right policy decisions, the government can start to turn the tide on extreme inequality. By tackling inequality, the government can help to lift millions out of poverty, ensure sustainable economic growth and start to bring together a divided country. Ultimately, this will help Kenya to meet its Vision 2030 goals and achieve SDG 10 on 'reduced inequalities'.²²⁸ By taking action now to tackle extreme economic inequality, the government can ensure a more prosperous and equitable future for all Kenyans.

1 REFORM THE PERSONAL TAXATION SYSTEM

The personal taxation system needs reform. Successive governments in Kenya have been wrong to try and shift the focus of personal taxation from direct to indirect taxation, as direct taxation is far more progressive. The personal income tax (PIT) system could do more to redistribute wealth and ensure that the highest income earners are paying their fair share, and a lack of wealth taxes prevents the tax system from redistributing wealth.

The government should:

- **Reform the personal income tax code by adding further bands for top earners at higher rates, and adjust the tax bands annually in line with inflation**

Kenya's PIT system is not doing enough to ensure that the rich and super-rich pay their fair share of tax. Over the years, the effective tax rates for the rich have reduced markedly. The ongoing review of the Income Tax Act provides an opportunity to make the personal income tax system more progressive. Recent evidence by the IMF shows that increasing tax rates for the rich does not hurt economic growth.²²⁹ The government should increase rates for the highest earners and add additional tax bands at the top of the tax system at higher rates. It should also consider removing those on the lowest incomes from the income tax net altogether.

Currently, the personal income tax bands are not sensitive to inflation, meaning that every year, low-income earners are required to pay more PIT despite no real-terms increase in their income. The Income Tax Act should also be amended to provide for annual inflationary adjustments to cushion low-income earners from inflationary increases:

- **Tax capital gains at the same rate as income, and apply the tax beyond property sales**

Capital gains in Kenya are taxed at the low rate of 5%, which compares unfavourably with Tanzania, where it is 10%, and with Uganda, where capital gains are taxed at the

same rate as income. The rate is minimal compared with personal income tax rates and VAT. Kenya should tax capital gains at the same rate as income, in order to make the tax more progressive and raise more revenue. The change would also prevent companies and wealthy individuals from recharacterizing their income as capital gains to dodge tax. The government should also explore options to apply capital gains taxation beyond property sales to ensure that other forms of capital gains are taxed, to raise additional revenue and contribute towards capital being taxed at the same rate as labour.

- **Launch a review of wealth taxation, with the aim of: introducing an inheritance tax; introducing a net wealth tax; and increasing land rates for the highest value land**

Taxes on wealth, including recurrent taxes on wealth and property and inheritance taxes, are an important tool to address inequality, as they are highly progressive, targeting only the richest section of society. Moreover, they are vital to prevent excessive concentrations of wealth and power in the hands of a few,²³⁰ and to ensure greater equality of opportunity across generations.

A lack of wealth taxation is limiting Kenya's tax base, and limiting its progressivity as wealth taxes are highly progressive. The only form of wealth tax levied in Kenya beyond capital gains is property tax, which takes the form of land rates payable to county governments, but the contribution of property taxes to total tax revenue remains very low. There is no inheritance tax, and no tax on accumulated capital or assets, such as a net wealth tax. The government should conduct a review of wealth taxation, with the aim of: introducing an inheritance tax to raise revenues and improve intergenerational equality and equality of opportunity; introducing a net wealth tax to reduce wealth inequality and ensure that the wealthiest taxpayers are paying according to their means; and increasing land rates for the highest value land to raise extra revenue to invest in essential quality public services. In order to accurately assess the value of land, the government should conduct a mapping and revaluation exercise, as undertaken in Sierra Leone, in order to base the tax on the current market price rather than by drawing on the historical and often inaccurate valuations currently in use.

2 END HARMFUL TAX COMPETITION

Competition between governments in every region of the world to offer ever more favourable tax regimes to global corporations and the super-rich is damaging their own economies and the economies of other countries, and is not in the public interest. Ultimately, the most harm falls on the public, which is faced with the triple impacts of a higher tax burden, declining public goods and services, and having to subsidize corporate profits and private wealth.

The government should:

- **Refrain from cutting corporate income tax rates any further**

Kenya must maintain its current corporate tax rates. Corporate tax cuts can be counterproductive, as lower rates do not automatically translate into better tax

compliance or significantly increased revenues. There is also a lack of any strong evidence that tax cuts increase foreign direct investment (FDI). Many studies cite factors that are more important in attracting FDI, including skills levels in the local economy, the availability of infrastructure and macroeconomic stability,²³¹ all of which are facilitated by a well-resourced state that can invest to improve these conditions. Kenya, like many other developing countries, is more dependent on corporate tax revenues than developed countries. A corporate tax cut is likely to further narrow Kenya's fiscal capacity to finance much-needed health, education and infrastructure programmes. Furthermore, it could encourage other governments in the region to compete by lowering their own tax rates, resulting in a race-to-the-bottom in which all states lose out, benefiting multinational corporations at the expense of the population.

- **Cease offering discretionary tax incentives and exemptions, and subject all new tax incentives to rigorous economic and risk assessments (including their contribution to global and regional 'races to the bottom'). All incentives should be regularly reviewed to limit private long-term benefits and public harm, and all tax exemptions should be phased out where there is no clear evidence that they are effective. A public record of all incentives and exemptions should be kept.**

Kenya has numerous tax incentives, including SPZs, EPZs and investment deduction allowances. Despite evidence to indicate that tax incentives do not play a key role in influencing the majority of investment decisions, Kenya continues to add to the tax incentives on offer, and the government rarely takes into account the cost of the incentives to the economy.²³² The Kenyan tax statutes give the Cabinet Secretary in charge of the National Treasury powers to exempt any income or class of income from tax. There is no set criteria for these waivers and the exemptions are at the discretion of the Cabinet Secretary.

The discretionary nature of many incentives and exemptions leaves them open to abuse, and so the Kenyan government should cease offering discretionary tax incentives immediately. All new tax incentives should be subject to rigorous economic and risk assessments to ensure that they do not harm the Kenyan economy or its ability to fund essential services. This assessment should include their contribution to regional or global races-to-the-bottom, whereby countries compete to offer an ever more favourable tax regime for corporations. If Kenya offers incentives then other countries are likely to follow suit, undermining the revenue base of both Kenya and its neighbours, with the only winners being the corporations. Furthermore, once granted, all incentives should be regularly reviewed to limit private long-term benefits and public harm, and all tax exemptions should be phased out where there is no clear evidence that they are effective. There should be checks and balances on the issuance of tax incentives and exemptions by ensuring the involvement of the Revenue Authorities and ultimate approval by the National Assembly. For further accountability and transparency, a record of all incentives and exemptions, along with their justification and beneficiaries, should be made publicly available and regularly updated.

- **Establish a framework for the conclusion of tax treaties, amend the Treaty Making and Ratification Act to bring tax treaties within the oversight of Parliament, and invest in the training of tax treaty negotiators. Review existing**

double taxation agreements to ensure that they are not being used by companies to shift profits to tax havens

Kenya currently does not have a framework or a policy on the conclusion of tax treaties. Tax treaties are negotiated and concluded on an ad hoc basis and at the discretion of the executive. There is also no framework for public participation or accountability, as tax treaties are excluded from the Treaty Making and Ratification Act, which provides for parliamentary oversight of the conclusion of tax treaties. Neither the Kenya Revenue Authority or the Treasury have a tax treaties department, and a lack of expertise in tax treaty negotiations means that Kenya is not equipped to secure a fair deal from negotiations.

The Kenyan government should establish a clear framework for the conclusion of tax treaties so that they are not at the discretion of the executive. Furthermore, the Tax Treaty and Ratification Act should be amended to include tax treaties to ensure that there is some parliamentary oversight of the process, and the government should invest in the training of tax treaty negotiators to build technical capacity for negotiations. In addition, existing double taxation agreements should be reviewed to ensure that they are not being used by companies to shift profits to tax havens, thus undercutting Kenya's revenue base.

- **Create a new taskforce on multinational companies and the ultra-rich to curtail illicit flows**

Kenya, like other countries in the region, is at risk of losing significant tax revenues to tax avoidance and evasion by wealthy individuals and big business. There is an urgent need for the government to bring together the various bodies involved to tackle pervasive illicit financial flows. The taskforce, which should be headed by the KRA, should bring together all the relevant ministries such as trade, tourism, industrialization, foreign affairs, the Attorney General's office, the police, judiciary, treasury, Capital Markets Authority, Central Bank, Kenya Investment Authority and the Chamber of Commerce. The taskforce should set out to review the policies of each agency/ministry and how they impact on illicit flows and revenue generation.

- **Build on efforts made to tackle transfer pricing by developing a database of local company comparables and building the capacity of the KRA and judiciary**

Kenya's transfer pricing regime has made great progress in tackling transfer mispricing and therefore corporate tax dodging. However, a lack of local company comparables makes it difficult to ascertain the arm's-length price for transactions. Another key challenge that has been identified is the capacity of the judiciary and, to some extent, within the KRA, although the latter has provided extensive training for its staff in an attempt to meet these concerns. The situation is more acute within the judiciary, where the judges tasked with making decisions on complex transfer pricing matters are not well versed in the technicalities of the topic. The KRA should endeavour to create a database of local company comparables, and build the capacity of staff at the KRA, and especially the judiciary, to deal with transfer pricing cases. Ultimately, this will help to tackle transfer pricing abuse and so ensure that greater revenues are available to invest in public healthcare and education.

- **Work at the regional level to develop a cooperation framework to combat base erosion and profit shifting. Kenya should join other governments in the East Africa Region to push for a second generation of international tax reforms, to be conducted by a Global Tax Body at the UN.**²³³

Corporate tax dodging is a regional problem and the Kenyan government should work with other countries in the region to tackle it. A minimum standard that could be developed by countries in the East Africa Region is the Action Plan on Base Erosion and Profit Shifting (BEPS), which was created in July 2013 by the OECD with the aim of tackling corporate tax avoidance.²³⁴ Kenya has joined the Inclusive Framework for the implementation of BEPS. At a minimum, Kenya should strengthen cooperation with the rest of the East Africa Region in order to implement BEPS in national legislation coherently. However, the BEPS Action Plan does not go far enough to fix the broken international corporate tax system, and has not put the interests of developing countries at the forefront. Kenya should also join other countries in the region to explore how to go beyond BEPS to develop region-specific solutions. Ultimately, a second generation of global tax reforms is needed, with the participation of all countries on an equal footing, ideally conducted by a Global Tax Body at the UN.²³⁵

- **Support national, regional and global efforts to promote tax transparency at all levels, including by requiring multinational companies (MNCs) to publish where they make their profits and where they pay taxes (through mandatory country-by-country reporting that is publicly available), as well as who really owns companies, trusts and foundations (through disclosure of beneficial ownership) to combat illicit financial flows**

The Government of Kenya should work to promote tax transparency at all levels, to make it more difficult for wealthy individuals and big business to dodge paying their fair share of tax. This includes through mandatory public country-by-country reporting, whereby all multinational companies are required to publish country-by-country reports (CBCRs) with separate data for each country in which they operate, including developing countries. A breakdown of their turnover, intra-firm sales, employees, physical assets, profits and current taxes due and taxes paid should be publicly available, to make it more difficult for companies to shift profits into tax havens and corporate tax dodging for good. It also includes centralized public registers of beneficial ownership of who really owns and benefits from companies, trusts and foundations in different jurisdictions, to make it more difficult for wealthy individuals to hide their assets offshore and therefore dodge tax.

- **Ensure the NIFC's full participation in multilateral anti-abuse, exchange and transparency initiatives, and ensure that withholding tax rates and corporate income tax rates do not contribute to harmful global tax competition**

Despite protestations from civil society, Africa's newest tax haven, the Nairobi International Finance Centre, was signed into law by the president on 21 July 2017. It runs the risk of encouraging more profit shifting out of Kenya, and the continent as a whole, depriving the country of vital revenues to invest in quality public healthcare and education services. It is another step towards the development of a network of tax havens across Africa and its near neighbours for a wealthy elite to exploit for tax abuse and criminal activity. At a minimum, the government must ensure the NIFC's participation in multilateral anti-abuse, exchange and transparency initiatives, and

that withholding and corporate income tax rates do not contribute to harmful global tax competition.

3 INVEST IN PROVIDING GOOD QUALITY FREE PUBLIC SERVICES FOR ALL

The most recent Demographic and Health Study found that a quarter of the Kenyan population regularly lack access to healthcare. The scarcity and low quality of public health facilities in Kenya exposes patients to unacceptable risks. When user fees are charged for schooling, some children can access high-quality private education, but the majority make do with poor-quality state education, creating a two-tiered system. Privatization further entrenches the disparities between the poorest and the richest, and undermines the ability of the state to provide for all. Investing in free public health and education services is a powerful and effective route to tackling both economic and gender inequality. Such sectors mitigate the impact of skewed income distribution, and redistribute by putting 'virtual income' into the pockets of the poorest women and men.

The Kenyan government is a poor performer when it comes to backing up its rhetoric on health and education with the investment required. In Oxfam's new Commitment to Reducing Inequality index,²³⁶ Kenya falls behind its East African neighbours and ranks a poor 34 out of a total of 40 sub-Saharan countries on government commitment to social spending on health, education and social protection. This must be urgently addressed by scaling up public financing and prioritizing these sectors, which are essential components of the fight against inequality.

Beyond more government financing, a more equitable distribution of financing and a greater policy focus on equity are crucial to improving the reach of the public system. For example, the government must ensure public schools (primary, secondary and tertiary education provided by national government, with early childhood education provided by county government) and health facilities (primary healthcare being provided by county government) are geographically accessible to the poorest communities, especially informal settlements and slum areas, as well as underserved rural communities. It must ensure that sufficient financing reaches the education and health sectors, address the inequitable practice of charging informal fees, and expand access to secondary education and tertiary healthcare by removing financial barriers. Finally, the government must target extra resources to schools and health facilities in the poorest communities to ensure they have the support to meet the health and learning needs of vulnerable and marginalized children.

The government should:

- **Guarantee free high-quality healthcare for all citizens, removing all user fees in healthcare and raise and allocate sufficient financing for free, quality public education systems according to national education plans;**
- **Learn lessons from other countries and avoid unworkable health insurance approaches which become de facto voluntary and exacerbate inequality. Move towards a tax-based health financing system in which everyone contributes according to ability and receives support according to need;**

- Implement national plans to fund healthcare and education, by spending at least 15% of government budgets on healthcare and 20% on education;
- Implement strict regulation for private sector healthcare and education facilities to ensure safety and quality, ensure access for all, regardless of ability to pay, and remove any undue publicly financed subsidies to incentivize further private sector growth;
- Ensure that women's health needs are prioritized, that sexual and reproductive rights are upheld, and that bilateral aid is not permitted to constrain women's access to reproductive health services. Progress on reducing the unacceptably high maternal mortality rate must be prioritized;
- Publish a plan to 'eliminate gender disparities in education' and 'ensure that all girls and boys complete free, equitable and quality primary and secondary education leading to relevant and effective learning outcomes' by 2030 in line with SDG3.

4 PUT GENDER AT THE HEART OF POLICY MAKING

Gender inequality is a driver and a consequence of economic inequality in Kenya. Economic policy is not only creating extreme inequality, but also entrenching discrimination against women and holding back their economic empowerment. Economic policies must tackle both economic and gender inequalities.

The government should:

- Implement economic policies and legislation to close the economic inequality gap for women, including measures that promote equal pay, decent work, access to credit, equal inheritance and land rights, and recognize, reduce and redistribute the burden of unpaid care;
- Systematically analyse proposed economic policies for their impact on girls and women, and improve data and data disaggregation in national and accounting systems – including below the household level – to monitor and assess such impact (for example, on the distribution of unpaid care work);
- Prioritize gender budgeting to assess the impact of spending decisions on women and girls, and allocate it in ways that promote gender equality;
- Provide universal child and elderly care services, to reduce the burden of unpaid care work on women and complement social protection systems;
- Ensure the provision of gender-sensitive social protection mechanisms to provide a safety net for women, in ways that provide an additional means of control over household spending.

5 STRENGTHEN THE SOCIAL CONTRACT BETWEEN CITIZENS AND THE GOVERNMENT

Tax and public spending can also help to strengthen the government–citizen compact, and improve public accountability and support citizen efforts to hold their government to account. The Constitution creates a framework for openness, accountability and public participation in all areas of public finance, including taxation. Citizens must be informed and able to engage in policy making to ensure that policies best reflect their interests, and to prevent the capture of policy making spaces by the elite.

The government should:

- **Roll out civic education on taxation and spending, to ensure that the public is well-informed on fiscal issues;**
- **Put in place mechanisms that allow and encourage citizen engagement in policy making. The public must take an active role in the formulation of tax and spend policies. The tax policy formation process needs to be transparent to enable this to happen;**
- **Measure programmes against how well they strengthen democratic participation and the voice of people to challenge economic and social inequalities;**
- **Require the disclosure of all lobbying activities and resources spent to influence tax policy making.**

ANNEX

1 CALCULATING PERSONAL INCOME TAX PROGRESSIVITY

Source: Government of Kenya, Budget Statements and Finance Bills, Various Issues

To calculate the effective tax rate of individuals earning different incomes, the tax brackets, rates and tax relief for a given year were applied to that income level. Family relief was used for years where there was a distinction between family relief and single relief. For example, the effective tax rate of someone earning Kshs500,000 in 1990 was calculated as follows:

Calculating the effective personal income tax rate of someone earning Kshs500,000 in 1990

First, the total personal income tax due is calculated based on how much of an individual's income is taxed at different rates. In 1990/91 the personal income tax brackets were as follows:

1 – 42,000 10%

42,001 – 84,000 15%

84,001 – 126,000 25%

126,001 – 168,000 35%

Over 168,000 45%

Therefore, someone earning Kshs500,000 would pay a rate of 10% on the first 42,000 of their income, 15% on the next 42,000, 25% on the next 42,000, 35% on the next 42,000, and 45% on the final 332,000 of their income (everything over 168,000).

The personal relief figure for that year is then deducted. Personal relief is a deduction made from the final tax bill of all individuals. In 1990 family relief was Kshs2400.

This gives a total personal income tax contribution of 182,700 (see calculation below).

$$(42000 * 0.1) + (42000 * 0.15) + (42000 * 0.25) + (42000 * 0.35) + (332000 * 0.45) - 2400 = 182,700$$

The effective personal income tax rate is then calculated by dividing their personal income tax contribution by their total income, and then multiplying by 100 to give a %. This gives an effective personal income tax rate of 36.5% (see calculation below).

$$\text{Effective PIT rate} = 182,700 / 500,000 \times 100 = 36.5\%$$

The historical tax brackets, rates and tax relief are provided in the tables below.

Table A1: Evolution of personal tax relief

	Personal Relief
1981/1982	Single relief of KShs600 and a special single relief of KShs820 for singles with children and married relief of KShs1800p.a.
1987/1988	Single relief KShs960, special single KShs1,200 and family relief KShs2,400 p.a. (140,000 individuals removed from tax net)
1991/1992	Single relief KShs1,320, family relief KShs2,640 p.a.
1992/1993	Single relief KShs1,452, family relief KShs2,904 p.a. (50,000 individuals removed from tax net)
1993/1994	Single relief KShs2,424, family relief KShs3,636 p.a. (150,000 individuals removed from tax net)
1994/1995	Single relief KShs3,636, family relief KShs5,460 p.a. (230,000 individuals removed from tax net)
1995/1996	Single relief KShs4,368, family relief KShs6,552 p.a. (130,000 individuals removed from tax net)
1996/1997	Personal relief combined into uniform personal relief of KShs7,200 p.a. (140,000 individuals removed from tax net)
1997/1998	Relief increased to KShs7,920 p.a. (152,000 individuals removed from tax net)
1998/1999	Relief increased to KShs8,712 p.a.
1999/2000	Relief increased to KShs9,600 p.a.
2000/2001	Relief increased to KShs11,520 p.a. (200,000 individuals removed from tax net)
2001/2002	Relief increased to KShs12,672 p.a.
2004/2005	Relief was increased to KShs13,944 p.a.
2016/2017	Relief was increased to KShs15,360 p.a.

Table A2: Evolution of personal income tax brackets, 1986–2017

Year	Annual Taxable Income (KShs)	Rate (%)	Year	Annual Taxable Income (KShs)	Rate (%)
1986–1987	1–36,000	10	1988–1989	1–39,600	10
	36,001–72,000	15		39,601–79,200	15
	72,001–180,000	25		79,201–118,800	25
	108,001–144,000	35		118,801–158,400	35
	144,001–180,000	45		158,401–198,000	45
	180,001–216,000	50		Over 198,000	65
	216,001–252,000	60			
	Over 252,000	65			
1990–1991	1–42,000	10	1992	1–46,000	10
	42,001–84,000	15		46,001–92,000	15
	84,001–126,000	25		92,001–138,000	25

	126,001-168,000	35		138,001-184,000	35
	Over 168,000	45		Over 184,000	45
1993	1-52,800	10	1994	1-60,000	10
	52,801-105,600	15		60,001-120,000	15
	105,601-158,400	20		120,001-180,000	20
	158,401-211,200	25		180,001-240,000	25
	211,201-264,000	35		240,001-300,000	35
	Over 264,000	40		Over 300,000	40
1995	1-78,000	10	1996	1-78,000	10
	78,001-156,000	15		78,001-156,000	15
	156,001-234,000	20		156,001-234,000	20
	234,001-312,000	25		234,001-312,000	25
	312,001-390,000	35		Over 312,000	35
	Over 390,000	37.5			
1997	1-82,080	10	1998	1-90,240	10
	82,081-164,160	15		90,241-180,480	15
	164,161-246,240	20		180,481-270,720	20
	246,241-328,320	25		270,721-360,960	25
	328,321-410,400	30		360,961-451,200	30
	Over 410,400	35		Over 451,200	32.5
1999	1-94,800	10	2000	1-104,400	10
	94,801-189,600	15		104,401-208,800	15
	189,601-284,400	20		208,801-313,200	20
	284,401-379,200	25		313,201-417,600	25
	379,201-474,000	30		Over 417,600	30
	Over 474,000	32.5			
2001	1-109,440	10	2002-2003	1-116,160	10
	109,441-218,880	15		116,161-225,600	15
	218,881-328,320	20		225,601-335,040	20
	328,321-437,760	25		335,041-444,480	25
	Over 437,760	30		Over 444,480	30
2004-2005	1-121,960	10	2016-17	1-134,164	10
	121,961-236,880	15		Next 126,403	15
	236,881-351,790	20		Next 126,403	20
	351,791-466,700	25		Next 126,403	25
	Over 466,700	30		Over 513,373	30

2. VAT INCIDENCE ANALYSIS METHODOLOGY

To carry out incidence analysis, household data on consumption patterns from the Kenya Integrated Household Budget Survey (KIHBS 2005, which is the latest survey data) was used. It is assumed that the burden of VAT is shifted entirely to consumers, so that consumers bear the tax burden in proportion to their purchases of taxable goods (Bird and Miller 1989; Elson 2006; Martinez-Vazquez 2001). The tax burden can be computed by multiplying the base (expenditure in this case) with the statutory tax rate. The rates that we applied are as specified under the VAT Act, whereby goods and services are characterized as either designated, exempt or zero-rated. We apply the rates as defined in the VAT Act 2013.

Table A3: Exempt goods and services under VAT Act 2013

	Exempt goods and services under VAT Act 2013
Exempt goods and services	<p>Goods: Agricultural inputs; petroleum products; laboratory products; live animals; unprocessed milk; processed milk; wheat/bread; eggs; meat; fruits and nuts; machinery; cereals except corn, wheat, barley and rye; petroleum products.</p> <p>Services: Exempt supplies include financial services, insurance, public education and training services, health (including veterinary) services, sanitary services, agricultural services, transport, burial and cremation, renting and leasing of land and housing, postal services, and social welfare services.</p>
Zero-rated goods and services	<p>Goods: Medicines and medical supplies; supply of liquefied Petroleum Gas, air transport, exports of goods and services</p> <p>Services: Exports; international air transport; export processing zone supplies; treatment and supply of water; supply of coffee and tea for auction</p>

Source: Compiled from VAT Act Cap 476

After applying the tax rates under the VAT law, the tax payable is given as the tax rate multiplied by the total expenditure for that particular commodity, which is aggregated for the household. The tax burden is then computed as the ratio of the tax payable to total expenditure for the household, which is disaggregated into food and non-food categories. For non-tax consumption, the only categories of data available to us were: medicines and medical care, sanitary items, fuel, transport fares and financial services. Further, households are aggregated into quintiles according to their total expenditure on food or non-food items.

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